

The **GSE** REPORT TM

Note: A considerable amount of activity and debate surrounding the GSEs have occurred in the last two weeks. Due to the Length of this GSE Report, a Special Supplement will be issued separately to report on the very informative seminar held by the American Enterprise Institute on March 24 discussing the “Public Purposes and Private Interests” of Fannie & Freddie.

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 - OFHEO's Proposed Rule Reports that if Proposed Risk-Based Capital Rule was in Effect on Specific Test Dates in 1996 and 1997, Fannie would have had Sizable Capital Shortfalls (\$3.5 Billion in 1996 and \$3.68 Billion in 1997) while Freddie would have had Adequate Capital
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- After All the Complaints and Criticisms of OFHEO's Proposed Rule, Fannie is Now Stating that the Risk-Based Capital Proposal would Not Affect their Performance
- Norwest Begins Historic Technology Alliance with Freddie – Norwest has Agreed to Sell Almost 100% of its Conforming Conventional Loans Exclusively to Freddie (Instead of Selling to Both Fannie & Freddie) – In Return,

Freddie will Accept Norwest Mortgage's Automated Underwriting Decisions – The Two Companies will work together to Increase Homeownership Opportunities and Lower Costs for Borrowers

- Mortgage Bankers Association calls the Agreement the First Significant Step to Delinking the Use of Fannie & Freddie's Automated Underwriting Technology Systems to Products and Services of the Secondary Market (First Step to Creating Open Architecture)
- Norwest/Freddie Alliance Considered a "Bond Blessing" for Freddie

Fannie Mae and Freddie Mac

- US Marshals Service is Using Fannie to Sell Seized or Forfeited Properties instead of its Usual Practice of Using Realtors – Realtors who Specialize in the Management and Sale of Foreclosed or Real-Estate Owned Properties are Extremely Concerned about Unfair Competition from Fannie & Freddie
- Mortgage Bankers Association Survey Finds that Lenders of all Sizes (71%) See Fannie & Freddie as Potential Direct Competitors
- Countrywide CEO Believes there are Concerns with Regard to Competition by the GSEs, but Considers the GSEs Valuable Partners
- *National Mortgage News* Website Takes Informal Poll on Fannie & Freddie – Results are Still Running Almost 3-1 in Favor of Confining Fannie & Freddie's Activities to Providing Liquidity for Lenders
- American Enterprise Institute (AEI) Held Conference on Fannie & Freddie on March 24 to Discuss "Public Purposes and Private Interests" (A Special Supplement to *GSE Report* will be Issued on this Conference)

Fannie Mae

- Fannie Partners with Software Vendor to Provide Automated Appraisals through Fannie's Automated Underwriting Technology Systems – Software Vendor Claims that Fannie will Ultimately Require Automated Appraisals
 - As Noted in the March 5 *GSE Report*, Appraisers are Worried about being Displaced because Fannie & Freddie are Pushing the Industry to Use their Technology to Automate Home Appraisals
 - Fannie also Hints that it Would Like to Use its Technology to Control Even More Items of the Origination Process – Fannie Hints at Moving into Traditional Activities of Servicers Such as Servicing Transfers, Training, Loss Mitigation
- In Yet Another Step Towards Having its Technology Control the Entire Origination Process – Fannie Announces a New Technology Pilot that would Automate Transactions Between Lenders, Brokers, and Fannie's Automated Underwriting System, and Fannie's Desktop Originator Software by Using an Internet Access Portal
 - First Time, Brokers Have Access to Fannie's Desktop Originator Software through the Internet
 - Analyst Believes it Puts Fannie Closer to the Consumer and Broker, and Helps Build Fannie's "Brand" Name
- Fannie Pulls One of its Ads in its New National Advertising Campaign after the Mayor of Toledo Complains that the Ad is Insulting to Toledo – the Ad Ran in the *Washington Post* on March 23
 - Although the Ad Appears as if the Person in the Ad is a Real Person, the Person is Actually Fictional (Is it Necessary for Fannie to Spend So Much Money on Advertising to Consumers when their Customers are Lenders?)
- Yet Another Mega-Advertising Campaign by Fannie Begins – Fannie Announces that it will Begin New Television Ads Touting the Success of a Neighborhood that was Rehabilitated
 - Fannie Says their New Ad will be Similar to Ads Last Fall that Featured Two Neighborhoods, one in San Antonio, the other in Charlotte, NC
 - (Although Fannie's Name was Featured Prominently throughout the Ad Featuring the San Antonio Neighborhood Last Fall – Fannie was Reportedly Not Involved in the Original Redevelopment of The Neighborhood (Only Contributed to a Neighborhood Playground) – Also, It Appears that Fannie Only Made a \$150,000 Contribution to the Neighborhood Featured in its New Ad)
- Fannie is a Major Investor in Another Commercial Bank and Credit Union
- County Commissioners in St. Petersburg Decide to Use its County Housing Finance Authority to be the "Lender" for a Proposed 200-Unit Affordable Housing Complex instead of Fannie, because Fannie's Administrative Costs were too High
- Fannie Expands its Technology Reach to Consumers and Hyperlinks its Website to Another Public Library System
- Fannie's Recent Swap which Allowed Holders of Fannie's Non-Benchmark Debt to Swap \$15 Billion of Non-Benchmark Debt for Fannie's Benchmark Notes was the Largest Non-Government Security in the Market – Exceeds the Value of Fannie's Previous Largest Benchmarks
 - Analysts Expect to See More Swap Offers from GSEs
 - The Swap Reportedly Lowered the Interest Expenses and Taxes for Fannie, While Avoiding the Hit to Earnings per Share

- Fannie's Exchange Offer was Also the First to Make Use of a Recent IRS Guideline on Exchange Offers that Makes the Offer Even More Attractive for Issuers (in this case, Fannie) and Investors

- Fannie's Technology Partner, Finet Holdings Corp., Names a New CFO and Senior VP (Finet Owns and Operates iQualify.com, the website that Allows Consumers Direct Access to Fannie's Automated Underwriting Technology Systems)
- Fannie Tops \$1 Billion in Business Using Actual/360 Payment Schedules through Fannie's Delegated Underwriting and Servicing/MBS Product – Fannie Notes that a Borrower Using this Actual/360 Method, will Pay More Interest on an Annual Basis than the Traditional 30/360 Method
- Fannie Further Expands its Political Reach by Including Federal and State Officeholders in their Press Conferences and Press Releases and by Increasingly Using their Partnership Offices (currently 35 offices – another added this week in the Bay Area of San Francisco, CA) in these Press Events
- Fannie Names New Members to its National Advisory Council
- Fannie Provides another REIT with a Credit Facility
- Fannie Partners with Bank of America to Fund Housing for Low-Income Chicagoans
- Fannie Provides Credit Enhancement for \$3.9 Million in Tax-Exempt Bonds to Help Finance a Multifamily Affordable Housing Complex
- Fannie Claims it Played a Key Role in the 90s Housing Boom
- Fannie Holds Several Events with NBA Teams
- Fannie Provides Home for Family of Seven Surviving Octuplets
- PepsiCo Names Fannie's Chairman to Board
- Fannie Executive Put to Task by Conservatives

Freddie Mac

- IRS Seeks \$76.7 Million in Back Taxes from Freddie Mac
- Warren Buffet's Annual Report Notes that he Sold a Number of Freddie Mac Shares

Federal Home Loan Banks

- Fannie Increases its Criticisms of FHLBank System's Mortgage Partnership Finance (MPF) Program – Ironically, While Fannie Criticizes OFHEO's Proposed Rule for Increasing Capital Requirements on Fannie, Fannie Lobbies Hard to Convince Congress and Other Regulators that a Competitor (FHLBank System) Has Insufficient Capital
 - Fannie writes FDIC Comparing the Risk of FHLBank's New Programs to S&L Crisis – Meanwhile, the FHLBank's New MPF Program is Becoming a Real Competitor to Fannie & Freddie
 - One of the FHLBanks is Reportedly Considering Asking the Justice Department's Antitrust Division to Look into Fannie's Activities to See if any Anticompetitive Behavior by Fannie
- The First Lender in TX to use the FHLBank's MPF Program (Bank United) and the National Association of Home Builders File Amicus Briefs with an Appeals Court Defending the MPF Program – Bank United Stated that the MPF Program allows Member Banks and Thrifts to Avoid the Higher Credit Guarantees Charged by Fannie & Freddie
- Treasury Secretary Rubin Criticizes the Non-Mortgage and Arbitrage Investment Activities of the FHLBank System – FHLBank Regulator Said He would Support any Investment Restrictions Placed on the FHLBanks as Long as it was Imposed on Fannie & Freddie as Well
- Addressing Criticisms about the FHLBank System's Non-Mortgage and Arbitrage Investment Practices, the FHLBank System's Regulator is Considering Requiring the FHLBanks to Redeem Excess Capital Stock that is Often Used to Finance "Arbitrage" Investments
- House Leadership Gives Commerce Committee a May 14th Deadline to Vote on House Financial Services Modernization Bill (H.R. 10) which Contains Five FHLBank Expansion Provisions
- *National Mortgage News* Runs Editorial on FHLBank System's MPF Program – Notes that MPF Program is the First Competitive Force in the Secondary Market to Establish Itself in Quite a While
- President of America's Community Bankers Responds to March 10 *Washington Post* Op-Ed which Referred to GSEs' (Most Specifically the FHLBanks) Arbitrage Investments as "A US Government Hedge Fund"
- Members of National Neighborhood Coalition Met with Council of FHLBanks to Press for Support of a Stronger Community Agenda by FHLBanks
- FHLBank of Pittsburgh Announced New Appointments to Board of Directors
- FHLBanks are Reportedly the World's Largest Contributor to Habitat for Humanity

Farm Credit System

- GSEs' Benchmark Issues are Seeking to Replace Treasuries as Pricing Benchmarks – Farm Credit Banks Follow Fannie & Freddie's Lead and Begin to Issue Large Non-Callable Debt, Marketed as Alternatives to Treasuries

Ginnie Mae

- Fannie, Freddie, and Housing Industry Trade Groups Voice their Opposition to a Ginnie Mae Privatization and User Fee Proposal in the Senate Budget Plan (Since a Privatized Ginnie Mae would No Longer Carry the Full Faith and Credit of the US Government, or Have the Implied Backing Provided Other GSEs, there was a Question as to whether a Privatized Ginnie Mae would Actually be able to Compete with Existing GSEs)

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OFHEO's Proposed Rule Reports that if Proposed Risk-Based Capital Rule was in Effect on Specific Test Dates in 1996 and 1997, Fannie would have had Sizable Capital Shortfalls (\$3.5 Billion in 1996 and \$3.68 Billion in 1997) and Freddie would have had Adequate Capital

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Background

- The Office of Federal Housing Enterprise Oversight (OFHEO), the safety and soundness regulator for Fannie and Freddie, was created by Congress in 1992 and was tasked by Congress to create a risk-based capital rule for Fannie and Freddie to be completed by December 1994. OFHEO has been working five years on the proposal. At issue, the risk-based capital proposal would determine the amount of capital Fannie and Freddie would be required to set aside to remain solvent during a 10-year period of severe credit and interest rate stresses. OFHEO sent the proposal to OMB for a 90-day review back in October of 1998, however, it took the OMB until March 26 to finish its

review. The proposed rule was then sent immediately to Congress on March 26 for a 15-day review period. After Congressional review, the proposed rule will be officially published in the *Federal Register* for a four-month-long public comment period. The new rules could go into effect at the earliest in 18 months, after OFEHO has heard public comments and gives Fannie and Freddie a year to comply with the new standards.

Fannie has Fought Release of Proposed Rule at Every Step of the Way

- Despite reportedly never seeing a copy of the proposed rule, Fannie has been fighting and strongly denouncing the release of the proposed rule and according to some government sources, asking that the proposed rule be withdrawn. Even as early as three days prior to OFHEO's submission to the OMB, Fannie's Vice Chair Jamie Gorelick wrote a letter to OFHEO voicing strong objection to OFHEO's inclusion of a specific capital number or percentage amount of capital required to be maintained by Fannie and Freddie. Fannie said that it objected to OFHEO disclosing a capital amount because it would create a misperception of capital inadequacy. Fannie also reportedly launched a "frontal assault" on the proposed rule by complaining to the OMB that OFHEO hadn't given Fannie any opportunity to engage in a dialogue about the proposal.
- Fannie then objected to the proposed rule stating that a risk-based capital rule would hurt its ability to serve low- and moderate-income borrowers. (This despite the fact that the GAO and HUD have both noted in reports and testimony that the private sector serves the low- to moderate-income homebuyer community substantially better than do either Fannie and Freddie, while at the same time holding substantially more capital than Fannie and Freddie.) Fannie Chairman Franklin Raines also objected to the proposed rule stating that if regulators devise one rule for both Fannie and Freddie, the two GSEs would be forced to look and act the same way, stifling competition. Raines further noted that "We fear they [OFHEO] have gone off and created their own model," and "No one there has ever bought a mortgage and held it in portfolio." Raines said he doesn't dispute the notion that new capital standards are necessary, but he objects to the approach being taken. Regulators at OFEHO said the new risk-based capital standards are needed because Fannie and Freddie now lack an incentive to hold adequate capital. (OFHEO's Acting Director Mark Kinsey has also stated that government sponsorship of Fannie & Freddie "shields" them from "the type of market discipline faced by fully private firms.")

Summary of the Proposed Risk-Based Capital Rule

- According to the Executive Summary of the OFHEO Proposal, the proposed risk-based capital rule utilizes a stress test to determine the amount of capital needed to protect against credit and interest rate risks, and requires an additional 30% more capital to protect against unspecified management and operations risk. The proposed rule contains a 435 page preamble and a 201 page rule. According to the Executive Summary, the proposed rule is the blueprint needed to construct the stress test and calculate the risk-based capital requirement for Fannie and Freddie. The Executive Summary also noted that the proposed rule, with its risk-based capital requirements, would help to ensure that Fannie and Freddie will be able to fulfill their important public purposes, both in good times and in bad times, when they will be needed most. **"The risk-based capital standard, when in place, will ensure that the quantity of risk undertaken by an Enterprise never exceeds what can be supported by its capital base and at the same time provide assurance that the Enterprises' relatively modest capital, as compared to other financial institutions, properly reflects the lower relative risk of most of the mortgages they guarantee."**

OFHEO's Proposed Rule Notes that if the Proposed Risk-Based Capital Rule were in Effect on Test Dates in 1996 and 1997, Fannie would have had Sizable Capital Shortfalls (Fannie would have been Short \$3.5 billion in 1996 and \$3.68 billion in 1997) while Freddie would have had Adequate Capital

- According to an Executive Summary of OFHEO's Risk-Based Capital proposed rule, using the proposed risk-based capital rule as an example of how the requirement would work, if OFHEO's risk-based capital proposal was in effect on two test dates – September 30, 1996 and June 30, 1997, Freddie would have exceeded its risk-based capital requirements, while Fannie would revealed a capital shortfall. In 1996, Fannie would have been undercapitalized by \$3.5 billion in 1996 and \$3.68 billion in 1997 because “its asset-liability structure was less well hedged against interest rate risk than Freddie Mac's.” According to the Executive Summary, however, given that underlying economic conditions and the GSEs' risk profiles constantly change, the results do not necessarily reflect what Fannie and Freddie's risk-based capital requirement might be at other times. In addition, OFHEO suggested that Fannie, which earned more than \$3.4 billion in 1998, could have met the June 1997 requirement by adjusting its debt structure at a cost of less than \$200 million a year. The Executive Summary included the following chart:

**Actual Capital and Required Capital Under the Proposed Risk-Based Standard
(Billions of \$)**

Date	Fannie Mae		Freddie Mac	
	Actual Capital	Required Capital	Actual Capital	Required Capital
9/30/96	\$13.05	\$16.55	\$7.23	\$5.66
6/30/97	\$14.05	\$17.73	\$8.11	\$6.83

- The Executive Summary notes that a “projected shortfall, even a large one, does not imply that an Enterprise actually has to raise that amount of capital. The proposed risk-based capital standard captures the “bottom line” risk exposure of the Enterprises, taking into account all of their risk-taking and risk-management activities, in light of current economic conditions. Therefore, an Enterprise can meet the requirement by reducing risk, raising capital, or a combination of the two. The proposed rule does not prescribe any particular approach to capital compliance.” According to the *American Banker*, Mark Kinsey, Acting Director of OFHEO, noted that the point of the stress test is to measure risk. “A higher capital requirement means higher risk, a lower capital requirement means lower risk,” he said. (*Office of Federal Housing Enterprise Oversight's Proposed Risk-Based Capital Regulation for Freddie Mac and Fannie Mae, Executive Summary, 3/26/99; American Banker, 3/29/99; BNA Daily Report for Executives, 3/30/99*)

While Fannie tried to Stall the Proposed Rule at OMB, Freddie's Chairman Leland Brendsel, House Banking Committee Chairman Jim Leach (R-IA), Senator Chuck Hagel (R-NE), Cong. Richard Baker (R-LA), and Numerous Financial Services Trade Groups all Pushed for OMB's Prompt Release of OFHEO's Proposed Risk-Based Capital Rule

- As we noted in previous GSE Reports, House Banking Committee Chairman Jim Leach (R-IA), House Banking Capital Market and GSE Subcommittee Chairman Richard Baker (R-LA) and Senator Chuck Hagel (R-NE) sent letters to the Director of the OMB, Jacob Lew, to request that the OMB promptly release the proposed rule under its review. A group of financial trade associations also wrote OMB Director, Jacob Lew, requesting that the OMB clear the proposed rule for public comment “as soon as possible.” The trade associations signing the letter were the Bankers Roundtable, Consumer Bankers Association, American Bankers Association, America's Community Bankers, and the Consumer Mortgage Coalition. The Mortgage Bankers Association

of America (MBA) sent a separate letter to Lew requesting that the OMB “clear the proposed rule for publication and comment as quickly as possible.”

- In contrast to Fannie’s stalling tactics, one day prior to OMB’s official release, Freddie’s Chairman Leland Brendsel called for the release of the proposed risk-based capital rule. In a speech to the Prudential Securities Reform and Regulation Conference on March 25, Brendsel stated that “In my view, we have been engaged in a productive process, consistent with what Congress intended. I hope we will soon see the proposed rule released for public comment. I think it’s time to get on with it.” (*Freddie Chairman Leland Brendsel’s Comments before Prudential Securities Reform & Regulation Conference, March 25, 1999*)

Fannie Claims that OFHEO Never Talked to Fannie Officials to Understand how their Business Works, However, OFHEO Claims it had “Hundreds of Meetings” with Fannie & Freddie on How they Measure and Model Risk – Freddie States it Gave OFHEO Extensive Comments

- According to the *BNA Daily Report for Executives* and the *Washington Post*, Fannie officials argued that OFHEO modeled the proposed rule without ever talking to Fannie officials to sufficiently understand how their business works.
- Acting OFHEO Director Mark Kinsey stated that OFHEO was barred by law from consulting with Fannie about the proposed rule before it was issued. However, he stated that OFHEO talked with Fannie and Freddie, as well as mortgage insurers, large banks and thrifts, and other private-market institutions, about how they handle risk. “We did not do this in an ivory tower,” Kinsey stated. “We have literally had hundreds of meetings with both enterprises on how they measure risk and how they model risk. We understand exactly how they do it.” An OFHEO spokeswoman denied that OFHEO neglected to talk with Fannie Mae about its business practices. OFHEO has had an “ongoing dialogue” for years about the way both Fannie and Freddie manage risk, the spokesperson said.
- Finally, Freddie officials have stated that their company has given extensive comments to OFHEO. On March 25, Freddie’s Chairman Leland Brendsel noted that “OFHEO has solicited public comment on all its rulemaking, giving ample time for all parties, including Freddie Mac, to engage and provide comments. Our extensive responses have been based on the knowledge we gained using stress tests in our business. As soon as the proposed risk-based capital regulation is published, Freddie Mac will mobilize our expertise to provide another round of comments to advocate the appropriate implementation.” (*BNA Daily Report for Executives, Marc Selinger, 3/30/99, 4/1/99; Washington Post, Kathleen Day, 3/27/99; Freddie Chairman Leland Brendsel before Prudential Securities Reform & Regulation Conference, 3/25/99*)

Fannie Objected to the Proposed Rule Stating that a Risk-Based Capital Rule would Hurt Its Ability to Serve Low- and Moderate-Income Borrowers – However, OFHEO Notes that the Affordable Housing Efforts of Fannie & Freddie would not be Affected by the Proposed Rule

- Fannie has recently objected to the proposed rule stating that a risk-based capital rule would hurt its ability to serve low- and moderate-income borrowers. (This despite the fact that the GAO and HUD have both noted in reports and testimony that the private sector serves the low- to moderate-income homebuyer community substantially better than do either Fannie or Freddie, while at the same time holding substantially more capital than Fannie and Freddie.)
- According to OFHEO’s Executive Summary, the Proposed Risk-Based Capital Rule would not change the fact that affordable housing loans have been quite profitable for Fannie and Freddie.

The Executive Summary pointed out the ability of Fannie and Freddie to meet the proposed standard while continuing to meet their affordable housing responsibilities is demonstrated by Freddie's risk-based capital surpluses in 1996 and 1997. OFHEO pointed out that Fannie's capital deficits weren't caused by the credit risk of affordable loans, but by unhedged interest rate risk. While Fannie had slightly riskier loans than Freddie on those dates, Freddie would "still have easily met the proposed standard if its loans had been as risky as Fannie's were."

- OFHEO also pointed out that under the proposed rule, the capital implications of low- and moderate-income borrowers are, on average, close to those of other loans and there isn't a special treatment for affordable housing loans in the stress test. OFHEO claims its capital rule does not penalize Fannie and Freddie for holding mortgages from borrowers with lower incomes and that the majority of loans that serve low- and moderate-income families are loans purchased through Fannie and Freddie's standard programs. Fannie's Chairman Raines claimed that by requiring more capital, the rule could institute "a huge issue for high loan-to-value lending" and other forms of finance for the low- and moderate-income sector. However, OFHEO points out that the loan-to-value distributions are actually more favorable for lower-income borrowers, again making the claim that Fannie and Freddie's affordable housing efforts, including those to high loan-to-value loans for low- and moderate-income homebuyers, will not be affected by the rule. OFHEO noted, "Consequently, the capital implications of single family loans vary little by income class." (*Office of Federal Housing Enterprise Oversight's Proposed Risk-Based Capital Regulation for Freddie Mac and Fannie Mae, Executive Summary, 3/26/99; Mortgage-Backed Securities Letter-American Banker, 3/22/99*)

Fannie Claims that OFHEO's Risk-Based Capital Rule would Mean Lenders' Guarantee Fees Might have to be Raised, However, OFHEO Points out that their Proposed Capital Rule is Unlikely to Cause Higher Mortgage Rates and would Not Give Fannie & Freddie Incentives to Raise their Guarantee Fees

- Fannie's Chairman Franklin Raines noted that under OFHEO's risk-based capital rule, no competitive benefit would accrue to those who view Fannie as a competitor. He stated that mortgage insurers, for instance, might be held to higher counterparty standards and lenders' guarantee fees might have to be raised, resulting in fewer loans for them. However, OFHEO noted that its "risk-based capital standard is unlikely to cause any changes in mortgage rates and will not give the Enterprises incentives to raise their credit guarantee fees. Because the rule will help ensure the continued health of Freddie Mac and Fannie Mae, borrowers will, in fact, benefit from the rule."
- Speaking at a Women in Housing and Finance luncheon, Acting Director of OFHEO, Mark Kinsey, stated that the rule "gives no incentive for Fannie Mae to raise guarantee fees," or what the company charges lenders for accepting credit risk with mortgages. That's because the capital costs associated with the credit risks that Fannie Mae shoulders are lower than current minimum capital standards today, he said. People are concerned about the public policy issues of affordable housing and [whether] this [is] going to cause mortgage rates to rise," Kinsey stated to reporters after the Women in Housing and Finance luncheon. "I think we have a very strong case that neither... will happen." (*Bloomberg News, 3/31/99; BNA Daily Report for Executives, 4/1/99; Mortgage-Backed Securities Letter -American Banker, 3/22/99*)
- OFHEO also cited recent studies by the Treasury Department and the Congressional Budget Office estimating that nearly 25% of the guarantee fees collected by Fannie and Freddie comprise profits

“over and above what is required to provide a normal return to shareholders.” OFHEO further writes, “these extra profits reflect benefits the enterprises receive by virtue of their GSE status that are not passed through to homeowners” and “provide a substantial cushion to absorb any added costs that might be associated with the proposed standard in unusual circumstances.” Therefore, OFEHO notes that the mortgage interest rate should be unaffected because Fannie and Freddie can reduce the profit cushion from their GSE status and still provide a healthy return to shareholders. (*Office of Federal Housing Enterprise Oversight’s Proposed Risk-Based Capital Regulation for Freddie Mac and Fannie Mae, Executive Summary, 3/26/99*)

Fannie Questions the Credibility of the Proposed Rule by Citing a “AA-” S&P Rating Given to Fannie and Freddie, However, OFHEO Notes that the S&P Rating Given to Fannie & Freddie was Not Based on Capital - S&P Stated that the Capital Levels for Fannie & Freddie were Relatively Low when Compared to what S&P would Expect to See at Fully Private Companies

- Fannie has been questioning the credibility of OFHEO’s Proposed Rule based on an S&P Rating that was issued to Fannie and Freddie. Fannie’s Spokesman John Buckley stated that “Any risk-based capital standard that says Fannie Mae was undercapitalized at precisely the same moment Standard & Poor’s was giving us a AA-rating has a credibility problem.” However, OFHEO’s Acting Director Mark Kinsey noted during a Women in Housing and Finance luncheon that the **S&P actually reported that Fannie and Freddie “maintain capital levels that are relatively low when compared to what S&P would expect to see at fully private companies with similar risk portfolios at the ‘AA-’ rating level.”** (S&P later writes in their report that “Their ability to issue debt instruments with ‘agency status’ enables Fannie Mae and Freddie Mac to access the capital markets even in times of financial stress, resulting in a high level of financial flexibility not experienced by fully private companies.” Thus, S&P’s rating was not based on Fannie and Freddie’s capital ratio, but rather on their ability to issue debt, even in times of financial stress, because of their status as a government-sponsored enterprise.) (*Final Report of Standard & Poor’s to OFHEO, 2/3/97; BNA Daily Report for Executives, 3/30/99; National Mortgage News website, 4/1/99* (Note: The Quote from Kinsey on the *National Mortgage News* website reports that the S&P Rating was “AA”, however, the S&P Rating was Actually “AA-” – Quotes were Changed to Reflect AA- Rating)

After All the Complaints and Criticisms of OFHEO’s Proposed Rule, Fannie is Now Stating that the Risk-Based Capital Proposal would Not Affect their Performance

- As we noted in the above story, Fannie has spent months, even years, complaining about OFHEO’s Proposed Risk-Based Capital Rule. On April 1, *National Mortgage News* reported that Fannie officials are now advising equity analysts that even if the OFHEO Proposal was put into effect today, the rule would not affect their company’s financial performance. Reportedly, Fannie’s Chief Financial Officer Timothy Howard said Fannie could reallocate its hedging dollars to get superior risk-based capital protection at no extra cost. Further, Fannie claims it could use subordinated debt for the first time to meet part of its risk-based capital requirement. “Taken together, we think it would be more than enough to eliminate the capital shortfall,” Howard stated. “Even if the reg doesn’t change at all, Fannie Mae would be able to adapt to it with no measurable impact on EPS [earnings per share] growth,” he stated. Fannie does, however, expect that the Rule will be changed significantly before it is finalized and believe they will be able to gain support for their view. (*National Mortgage News website, posted 4/1/99*)

Norwest Begins Historic Technology Alliance with Freddie – Norwest has agreed to Sell Almost 100% of its Conforming Conventional Loans Exclusively to Freddie (Instead of Selling to Both Fannie & Freddie) – In Return, Freddie will accept Norwest Mortgage’s Automated Underwriting Decisions – The Two Companies will work together to Increase Homeownership Opportunities and Lower Costs for Borrowers

Mortgage Bankers Association calls the Agreement the First Significant Step to Delinking the Use of Fannie & Freddie’s Automated Underwriting Technology Systems to Products and Services of the Secondary Market (First Step to Creating Open Architecture)

Norwest/Freddie Alliance Considered a “Bond Blessing” for Freddie

- Norwest Mortgage and Freddie have entered into an historic alliance to jointly develop new programs and products designed to lower costs for homebuyers and increase homeownership. Under the alliance, Freddie has agreed to purchase loans originated using Norwest’s Automated Underwriting Technology – ECS System. Each company will use its own underwriting systems – Norwest (ECS) and Freddie (Loan Prospector). Under the alliance, Norwest will sell nearly 100% of its conforming conventional loans to Freddie instead of Fannie and Freddie. In 1998, Norwest reportedly delivered \$57.6 billion of conventional, conforming loans to Freddie and Fannie. Norwest reportedly sold 56% of its mortgages to Fannie and 44% to Freddie in 1997, according to Anita Liskey, a Wells Fargo and Norwest spokeswoman. Numbers for 1998 were not yet available. According to Liskey, the new alliance doesn’t restrict Norwest from working with Fannie, since a large portion of Norwest Mortgage’s servicing portfolio consists of Fannie Mae loans.
- “We are very pleased to enter into this business alliance with Freddie Mac,” stated Mark Oman, CEO of Norwest Mortgage. “Over the years, our two organizations have worked to benefit homebuyers across the country. Through this important initiative, we will further strengthen our efforts by working even more closely together to share data and information as well as align our underwriting process. Ultimately, our borrowers will realize both time and cost savings as a result of our joint efforts. Additionally, because Norwest will continue to use our own time tested and proven risk management tools – notably our proprietary ECS system which has been continually enhanced since 1993, we will continue to deliver high quality products.” John Fisk, Executive Vice President of Freddie’s Single-Family Securitization Group stated that the two companies would “leverage” their “respective automated underwriting expertise to tackle the most difficult loans, streamline our processes and drive down costs for Freddie Mac, Norwest, and, importantly, for borrowers.” In addition, Norwest and Freddie will also work together to develop new programs and products for borrowers, including alternative products such as Alternative A loans.
(Norwest/Freddie press release, 3/24/99; Des Moines Register, 3/25/99; Portland Oregonian, 3/25/99)

Mortgage Bankers Association calls the Agreement the First Significant Step to Delinking the Use of Fannie & Freddie’s Automated Underwriting Technology Systems to Products and Services of the Secondary Market

- Paul Reid, Executive Vice President of the Mortgage Bankers Association (MBA) called the Norwest/Freddie Mac partnership “an improvement for the industry.” He stated that it was “the first step of many that will lead to a complete open-architecture situation,” in which other mortgage bankers and insurers could use their own automated underwriting technology systems to originate

and sell loans to the GSEs. According to a “Fast Facts” notice on MBA’s website, the MBA called the partnership the “first significant step to delinking the use of the GSE’s proprietary Automated Underwriting Systems to products and services of the secondary market.” The “Fast Facts” also noted that the requirement – still in place for lenders other than Norwest – that loans be submitted through Fannie and Freddie’s automated underwriting technology systems “has represented an unnecessary cost and step for our members who have developed their own AU systems.” “We hope that this announcement will encourage both Fannie Mae and Freddie Mac to approve systems of other mortgage bankers and of the private mortgage insurers,” said Donald Lange, President of the MBA, “so MBA members of all sizes will be able to select from a variety of capable automated underwriting systems.” According to *Real Estate Finance Today*, Lange also pointed out that by requiring their seller/servicer customers to rely exclusively on the GSE’s proprietary automated underwriting systems, Fannie and Freddie have unnecessarily raised the cost to mortgage firms, particularly those like Norwest that have developed their own automated underwriting systems.

- Industry observers reportedly endorsed the deal, saying it represented a long-awaited move away from originations dominated by the GSE’s proprietary automated underwriting system technology and toward more open cross-industry technology architecture. According to Liskey at Norwest, “The ability to have open architecture is a big plus for us. We’re not having to put costs into transforming systems, so it’s a very big cost savings for us and for consumers.” (*MBA “Fast Facts”*, MBA website, 3/24/99; *American Banker*, Joshua Brockman, 3/30/99; *Real Estate Finance Today*, Electronic Edition, 3/26/99)

Norwest/Freddie Alliance Considered a “Bond Blessing” for Freddie

- According to *Bloomberg News*, the new Norwest/Freddie alliance might give Freddie’s mortgage-backed securities a boost. The article notes that in the past, investors were willing to accept less yield when buying Fannie’s mortgage securities than they have with Freddie’s. Normally, the Fannie issues are larger in size, which makes them easier to sell or buy quickly. However, with the new alliance, this may change as the size of Freddie’s mortgage securities sales will probably increase. “The impact will not be immediate, but gradual,” on the spread between the securities,” said Michael Youngblood, Head of Mortgage and Real Estate Research at BankAmerica Corp. “It will be interesting to see if investors will overweight Freddie Mac securities versus Fannie Maes for the year, to profit from this trade.” Over the past five years, investors have reportedly demanded an average of 0.03% more in yield to buy Freddie’s 30-year 7% coupon securities over their Fannie’s counterparts. The spread is currently 0.01%. “We think it will be positive for the performance” of Freddie mortgage-backed securities, said John Fisk, Executive Vice President of Single-Family Securitization Group. Fish said he believes Freddie’s mortgage-backed securities will trade at a better price than they do currently. (*Bloomberg News*, 3/26/99)

Fannie Mae and Freddie Mac

US Marshals Service is Using Fannie to Sell Seized or Forfeited Properties instead of its Usual Practice of Using Realtors – Realtors who Specialize in the Management and Sale of Foreclosed or Real-Estate Owned Properties are Extremely Concerned about Unfair Competition from Fannie & Freddie

- According to *National Mortgage News*' website, Fannie is selling residential properties that have been seized by and forfeited to the US Marshals Service. According to Bill Dempsey, a Spokesman for the Marshals Service, a pilot program with Fannie was started in October of 1998, and Fannie is marketing 52 properties – selling 11, with 19 under contract. “We use private Realtors but we decided to give Fannie Mae a try,” Dempsey stated to see if they offered the “best value.” Dempsey reported that the pilot will be evaluated in October. *National Mortgage News* reported that two years ago Fannie started offering its real estate disposition services to lenders to help them dispose of their non-Fannie loans that had gone into foreclosure. Realtors who specialize in sales of real estate owned properties have voiced concern about Fannie and Freddie's entrance into the business. (*National Mortgage News website*, posted 3/31/99)
- According to Brian Collins with *National Mortgage News*, a group of realtors, who specialize in the management and sales of foreclosed or real estate owned (REO) properties, have formed a group made up of realtors and attorneys in California, Texas and Illinois. Coalition Spokesman Bruce Koklich stated that the **“default real estate market which the GSEs have already infiltrated is only an avenue into the relocation and general estate market.”** Koklich calls Fannie and Freddie's activities **“charter creep,”** and the Coalition argues that the **“GSEs represent unfair competition that is breaking established relationships between Realtors and lenders.”** The Coalition has asked the California Association of Realtors (CAR) to examine the issue and a working group is expected to present a report on Fannie and Freddie's activities to CAR's board of directors in June. Koklich stated that “All we can do is continue to point out the facts and we pray that CAR and NAR rise to the challenge to protect their members from further GSE encroachment into the real estate brokerage industry.” The article noted that the GSEs deny that they are interested in getting into the relocation or general brokerage business, however, when it comes to REO activities, Fannie reportedly believes it can provide any service, even if it means purchasing REO from a customer. (*National Mortgage News*, Brian Collins, 3/8/99)

Mortgage Bankers Association Survey Finds that Lenders of all Sizes (71%) See Fannie & Freddie as Potential Direct Competitors

- According to an article in the *Real Estate Finance Today*, in January 1998, a survey was commissioned by the MBA to gauge mortgage banker attitudes about the GSEs. The survey found that a majority of mortgage lenders of all sizes believe that Fannie and Freddie plan to provide mortgage services directly to consumers. Nearly three-quarters (71%) of the companies polled believed that the GSEs have plans to originate business directly with consumers. The survey found that 29% did not believe Fannie and Freddie would compete with the industry. Mortgage bankers cited Fannie's emphasis on television and print advertisements focusing on housing in America, HomePath Advisor, and other direct outreach efforts as evidence of a change in Fannie's business strategy. Freddie's online Mortgage Explorer and Freddie's relationship with IMX Mortgage

Exchange, as well as advertising, were also cited by lenders as placing the company to market directly to consumers.

- The survey found that 76% of mortgage companies do not think the GSEs should play a role in direct outreach to consumers. The survey also found that 83.4% of large companies believed Fannie and Freddie's automated underwriting technology systems competed directly with their technology products. Most of the lenders surveyed didn't believe Fannie and Freddie should provide technology directly to brokers. (*Real Estate Finance Today, Electronic Edition, 3/26/99*)
- (Considering all the new outreach activities and advertising to consumers, the increasing technology market share by Fannie and Freddie, the increase by the GSEs in tying the use of their technology to their products, Freddie's failed self-insurance amendment, and Fannie and Freddie's increasing efforts to push their technology systems onto brokers and even consumers - a 1999 survey would possibly reveal a greater number of mortgage bankers concerned about competition from the GSEs.)

<p style="text-align: center;">Countrywide CEO Believes there are Concerns with Regard to Competition by the GSEs, but Considers the GSEs Valuable Partners</p>
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- An *American Banker* article by Marc Hochstein and Joshua Brockman profiled the Chairman and Chief Executive Officer of Countrywide Credit Industry, Angelo Mozilo. The article notes that there is a lot of tension in the mortgage industry currently over the GSEs' movement into mortgage insurance and their increasing tying of the GSEs' proprietary automated underwriting technology to products. Mozilo said he shares lenders' frustrations with some of the GSEs' initiatives to expand their market, however, he considers the GSEs vital partners, without whom his company's success would not have been possible. According to the authors, Mozilo would like to keep the relationship between mortgage bankers and the GSEs positive and constructive and does not wish to join efforts with others in the mortgage industry to address GSE expansion efforts. Mozilo reportedly stated that "I don't want a war. Nobody wins in a war... I am an ally of the GSEs, not a foe at all. Without them, there would be no Countrywide."
- The article did note that Mozilo had some concerns about the GSEs, noting the GSEs' aggressive pursuit of business areas that have brought profits to lenders bothers him. "If it's a transfer of wealth from me to the GSEs, then I don't like that," stated Mozilo. "It's an abuse of power." Mozilo further noted his concerns with the GSEs' increasing requirements to use the GSEs' automated underwriting technology systems. "Being forced to go through their underwriting engine creates a problem, certainly for us," Mozilo stated. Mozilo believes that the GSEs' insistence that lenders use the GSEs' automated underwriting technology makes the loan process less efficient and more expensive. Mozilo was also critical of efforts by the GSEs to push their technology systems onto to brokers - allowing brokers to access the GSEs' automated underwriting systems and then shop the loans to lenders. Mozilo believes that gives brokers leverage with lenders, without rewards to consumers. In a perfect world, "I'd like the GSEs to realize that they have infinite power, and manage that power, not abuse it," he stated. Mozilo also expressed his desire to eliminate the 3% down payment required for low- and moderate-income loans, noting that VA loans, which require no down payment, have lower delinquency rates than FHA loans.
- Reportedly, Mozilo's goal is to keep the relationship between mortgage bankers and the GSEs positive and constructive. Mozilo also hinted that his company was trying to work out a possible

agreement between Countrywide and at least one of the GSEs for favorable treatment due to the large volume of loans Countrywide feeds to the GSEs. (*American Banker*, Marc Hochstein and Joshua Brockman, 3/22/99)

National Mortgage News Website Takes Informal Poll on Fannie & Freddie – Results are Still Running Almost 3-1 in Favor of Confining Fannie & Freddie’s Activities to Providing Liquidity for Lenders

- The *National Mortgage News* website (<http://nmnews.fgray.com>) included the following survey question on its website: “Should Congress confine the activities of Fannie Mae and Freddie Mac to those that provide liquidity for lenders?” As of 4/2/99, 11:00 a.m., the results for the poll were running almost 3-1 in favor of confining Fannie and Freddie’s activities. The results were 221 people voting “Yes” and 81 people voting “No.”

***American Enterprise Institute (AEI) Held Conference on Fannie & Freddie on March 24 to Discuss “Public Purposes and Private Interests”
(A Special Supplement to GSE Report will be Issued on this Conference)***

Fannie Mae

Fannie Partners with Software Vendor to Provide Automated Appraisals through Fannie’s Automated Underwriting Technology Systems – Software Vendor Claims that Fannie will Ultimately Require Automated Appraisals

(As Noted in the March 5 GSE Report, Appraisers are Worried about being Displaced because Fannie & Freddie are Pushing the Industry to Use their Technology to Automate Home Appraisals)

Fannie also Hints that it Would Like to Use its Technology to Control Even More Items of the Origination Process – Fannie Hints at Moving into Traditional Activities of Servicers Such as Servicing Transfers, Training, Loss Mitigation

- Fannie announced that it had partnered with United Software Systems Co. to enable users of Fannie’s automated underwriting technology system, Desktop Underwriter, to receive electronic appraisals. The connection reportedly would be free to lenders but not to appraisers. The appraisers would have to pay United for the software. The connection will be available in May to all lenders using Fannie’s Desktop Underwriter System.
- According to an article in the *American Banker*, Michael Schafer, President of United Software Systems, said the arrangement with Fannie is not exclusive and Fannie is looking for other vendors. Schafer stated that he expects the partnership with Fannie to double the use of his appraisal software but “lenders have to be adamant about using technology,” he said, “because appraisers will tend to be status-quo.” Schafer noted that lenders would be free not to use the service but **“ultimately I think Fannie will require automated appraisals.”** (*American Banker*, Hala Habal, 3/29/99; *Business Wire*, 3/25/99; *Fannie press release*, 3/25/99)

(As Noted in the March 5 GSE Report, Appraisers are Worried about being Displaced because Fannie & Freddie are Pushing the Industry to Use their Technology to Automate Home Appraisals)

- As we noted in the March 5 GSE Report, an article in the *ABA Banking Journal* noted that Fannie and Freddie are pushing the industry to automate appraisals that would provide lenders with a near-instant collateral assessment without relying on a human appraiser. The article notes that because Fannie and Freddie support the use of automated appraisals, lenders are assured that the GSEs will purchase loans in which automated home appraisals are used. The article notes that automated appraisals will to some degree displace appraisers. (*ABA Banking Journal*, 1/99)

Fannie also Hints that it Would Like to Use its Technology to Control Even More Items of the Origination Process – Fannie Hints at Moving into Traditional Role of Servicers Such as Servicing Transfers, Training, Loss Mitigation

- According to an *American Banker* article by Hala Habal, Jeffrey Hayward, Fannie's Vice President of Servicer Relations, stated that Fannie is determined to make changes in its suite of servicing products. "We feel now is the time," he said. For example, the article notes that Fannie is pushing to make Internet connections linking servicers, mortgage insurance companies, and attorneys. Fannie would also like to introduce on-line tools for loss mitigation with servicer-based applications, he stated. "Each servicer is different, as in each case, so this function would have to be customized." Hayward also reportedly stated that he would like to see credit scores used to identify potential bankruptcies and isolate them from the remainder of the application pool. And finally, Fannie would like to encourage Web-based functions such as servicing transfers and preparation of monthly reports. Hayward further noted that Fannie would also like to start using teleconferencing to deliver servicing training. Fannie may also begin distributing policy changes over the Web and by electronic mail, instead of mailing paper copies. (*American Banker*, Hala Habal, 3/29/99)

In Yet Another Step Towards Having its Technology Control the Entire Origination Process – Fannie Announces a New Technology Pilot that would Automate Transactions Between Lenders, Brokers, and Fannie's Automated Underwriting System, and Fannie's Desktop Originator Software by Using an Internet Access Portal

First Time, Brokers Have Access to Fannie's Desktop Originator Software through the Internet

Analyst Believes it Puts Fannie Closer to the Consumer and Broker, and Helps Build Fannie's "Brand" Name

- Fannie announced that it will begin a test pilot program with the Lenders Interactive Online Network (LION) – a unit of Plenum Communications Inc. - to automate transactions between mortgage brokers, lenders, Fannie's automated underwriting system, and Fannie's Desktop Originator software – by using the LION's portal website (www.lioninc.com). (LION's website currently operates as a wholesale mortgage industry Internet portal used by wholesale lenders to provide daily product and rate information to thousands of mortgage brokers.) LION stated that under the pilot, lenders would be able to offer sponsored brokers access to Fannie's automated underwriting system - Desktop Underwriter and Fannie's Desktop Originator Software System through the Lenders Interactive website. Once the pilot is complete, LION will join Byte, Alyx, Contour, and Genesis as the fifth technology provider to integrate Fannie's Desktop Originator

fully into its system. But unlike LION, lenders must install the other four origination systems onto their computers. With the LION pilot, Desktop Originator can be accessed over an Internet portal for the first time.

- The pilot program with LION will reportedly begin by mid-April and if there are no problems, full-scale rollout could occur in June. Brokers in the Fannie program would be able to use the LION website service whether or not they originate loans. The lenders involved in the pilot program are HomeSide Lending Inc., Flagstar Bank, CrossLand Mortgage Corp. and FT Mortgage Cos. – reportedly among Fannie’s “most active long-term Desktop Originator lenders.”
- In the past, Fannie processed underwriting applications through its Desktop Originator Software using a private dial-up network. Using the LION website will reportedly allow sponsored brokers access to Desktop Originator using the LION website to certify underwriting decisions and conditions while the broker is sitting with the borrower during the initial visit. The LION website connects the broker to Desktop Originator and then submits the loan for consideration to a lender. The lender then decides whether or not to underwrite the loan, giving the decision back to the broker.

Analyst Believes it Puts Fannie Closer to the Consumer and Broker, and Helps Build Fannie’s “Brand” Name

- The alliance with LION puts Fannie “in closer touch with the broker,” said Richard Beidl, an Analyst at the Tower Group in Needham, MA. Traditionally, neither Fannie nor Freddie has had broker relationships as close as those with major lenders,” he stated. The partnership “allows Fannie Mae to move one step closer to the end-user, the customer,” Beidl stated. And it is also a way for Fannie to “really brand itself,” he added. (*American Banker*, Joshua Brockman, 3/31/99; *Dow Jones Newswire*, 3/26/99; *Fannie press release*, 3/22/99; *PR Newswire*, 3/26/99; *Mortgage Marketplace-American Banker*, 3/29/99; *Seattle Post-Intelligencer*, 3/23/99; *Spokesman-Review*, 3/30/99)

As reported in the March 5 GSE Report, Morgan Stanley Dean Witter Analyst Kenneth Posner wrote that “Fannie Mae and Freddie Mac will use the Internet to accelerate the use of their automated underwriting systems. In so doing, they will create a growing class of originators who are dependent on agency technology and thus less likely to negotiate pricing or hold back from selling loans.” (*Morgan Stanley Dean Witter- US and the Americas Investment Research, US Savings & Loans/GSEs & Mortgage Finance, The Internet Mortgage Report: New Models, New Opportunities*, Kenneth Posner, 2/4/99)

Fannie Pulls one of its Ads in its New National Advertising Campaign after the Mayor of Toledo Complains that the Ad is Insulting to Toledo – The Ad Ran in *Washington Post* on March 23

Although the Ad Appears as if the Person in the Ad is a Real Person, the Person is Actually Fictional (Is it Necessary for Fannie to Spend so Much Money on Advertising to Consumers when their Customers are Lenders?)

- Fannie pulled a national ad because of a complaint from Toledo, OH Mayor Carty Finkbeiner. The ad featured a woman smiling in front of a tidy-looking house. The headline: “Jennifer Cooke’s job took her to Cincinnati. Her down payment only got her to Toledo.” The nearly full-page ad was

published in the March 23 *Washington Post* and was reportedly to be published in a number of national publications the following week.

- “We had several people read it before we raised any objections and everyone who we asked...thought it was distasteful and insulting to Toledo,” said city Spokeswoman Mary Chris Skeldon. The Mayor complained in a letter on March 24 stating “The city of Toledo finds this article counter productive to our overall growth and prosperity as it appears to favor one Ohio community over and above another...Furthermore, by not recognizing the city of Toledo as offering equally viable housing opportunities, our efforts to attract new business and developers to our city is adversely affected.”
- Fannie reportedly apologized and changed the ad. “What we were referring to was the length she could go geographically in terms of housing,” said Fannie Spokeswoman Janice Daue. “In no way did we mean to disparage Toledo.” Fannie changed the ad to read: “Jennifer Cooke’s job took her to Cincinnati. Her down payment couldn’t quite get her there.” Charlene Kramer, Fannie’s Vice President of Corporate Communications, called the use of Cincinnati and Toledo “a creative jumping-off point” developed by Fannie’s advertising agency, based in Austin, TX. “I appreciate the apology and prompt response” stated Finkbeiner. “Although I am sure that Fannie Mae’s intent was not to offend Toledo or anyone involved, the ad clearly had derogatory connotations, and I am pleased it has been removed.”
- Reportedly, Cong. Marcy Kaptur (D-OH) was meeting with Fannie officials on an unrelated matter on March 24 and during the meeting, she expressed her disappointment with the ad. “You wonder where people get these ideas,” she said. “We are pleased they agreed to redo the ad.” Cong. Kaptur said she had been meeting regularly with Fannie officials to get them more involved in downtown Toledo’s revitalization. “We’re making excellent progress with them,” she said. “But apparently, the right hand doesn’t know what the left hand is doing. I can’t believe they did that.”
- According to Daue at Fannie, the “Jennifer Cooke” in the Fannie ad was reportedly not a real person, but exemplified how someone who is moving can use a Fannie Mae loan.

Fannie is Ramping Up a National Advertising Campaign that will Run for the Next Several Months

- Reportedly the Toledo ad was the first of several ads planned for the next several months in national publications. Kramer declined to say what the campaign is costing Fannie. Fannie ran a different, nearly full-page ad in the *Washington Post* on March 25 featuring a little boy whose parents moved into their “dream home” before their son, “Luke Crawford’s” first day of school because their lender used Fannie’s automated underwriting technology. It is unclear whether “Luke Crawford” like “Jennifer Cook” is a fictional person. (There are no disclaimers on Fannie’s “Toledo” or “Luke Crawford” ads stating that “Jennifer Cook” and “Luke Crawford” are not real people.) (*Akron Beacon Journal*, 3/25/99; 3/26/99; *The Toledo Blade*, 3/25/99, 3/26/99; *Washington Post ads*, 3/23/99, 3/24/99)

Yet Another Mega-Advertising Campaign by Fannie Begins – Fannie Announces that it will Begin New Television Ads Touting the Success of a Neighborhood that was Rehabilitated Fannie Says their New Ad will be Similar to Ads Last Fall that Featured two Neighborhoods, one in San Antonio, the other in Charlotte, NC

(Although Fannie's Name was Featured Prominently throughout the Ad Featuring the San Antonio Neighborhood Last Fall - Fannie was reportedly Not Involved in the Original Re-Development of the Neighborhood (Only Contributed to a Neighborhood Playground) - Also, It Appears that Fannie only Made a \$150,000 Contribution to the Neighborhood Featured in its New Ads)

- The Fannie Mae Foundation issued a press release announcing that its spring outreach advertising effort, which begins on March 24 on national cable and broadcast network television, will feature another neighborhood transformed by homeownership – Portland's King neighborhood in Northeast Portland. Last fall, the Fannie Mae Foundation ran ads featuring two neighborhoods, Coliseum Oaks in San Antonio and Genesis Park in Charlotte, NC. The King's neighborhood ads will be similar. It appears from the press release, that Fannie's contribution to the neighborhood was only a \$150,000 grant by the Fannie Mae Foundation to the HOST Development Corp., which managed the rehabilitation of seven houses as part of Fannie's HomeTeam partnership with the Portland Trailblazers. (*PR Newswire*, 3/24/99)
- As reported in the October 2, 1998 *GSE Report*, the Fannie Mae Foundation spotlighted the San Antonio neighborhood, Coliseum Oaks, in 30-second and 60-second commercials. The San Antonio Housing Trust presided over the project, which converted 15 acres of abandoned, dilapidated rental housing into a new subdivision of moderately priced homes. CIO Foundation of Waco provided \$800,000 in down payment assistance. According to the *San Antonio News Express*, the Fannie Mae Foundation was not involved in the original development, but did contribute to a neighborhood playground. Anne Wheelock, President of the Fannie Mae Foundation, said the neighborhood was selected for the advertising campaign because it represents how homeownership can transform an area. (*San Antonio News Express*, 9/30/98)

Fannie is a Major Investor in another Commercial Bank and Credit Union

- According to a Fannie press release, as part of its "HouseOakland" program in Oakland, CA, Fannie Mae made a **\$655,000** investment in the Community Bank of the Bay – a new community development bank in downtown Oakland. Fannie also purchased a \$100,000 CD in the Allen Temple Baptist Church Federal Credit Union to assist in providing loans to low-income members, affiliate churches throughout the Bay Area, and the Oakland NAACP. Both investments were made through Fannie's Community Development Financial Institutions (CDFI) initiative. (*Fannie press release*, 3/29/99)

County Commissioners in St. Petersburg Decide to Use its County Housing Finance Authority to be the "Lender" for a Proposed 200-Unit Affordable Housing Complex instead of Fannie, because Fannie's Administrative Costs were too High

- According to an article in the *St. Petersburg Times*, county commissioners in St. Petersburg decided to use their county's Housing Finance Authority rather than Fannie as the "lender" for Pasco Woods, a proposed 200-unit affordable housing complex in Wesley Chapel. According to Commissioner Steve Simon, the county will not incur any administrative costs just so Pasco Woods' developers can save money, according to a letter sent by Todd Borck, a developer on the project. Pasco Woods will also hire people to administer the bonds, Borck said. The county will also not have to put up any money to back the \$8.4 million in tax-exempt bonds and \$600,000 in

taxable bonds that the developer needs. That money would come from the Florida Affordable Housing Guarantee, according to officials from bond underwriter William R. Hough & Co. Using the state's affordable housing guarantee fund will save the developer's money, said Bonnie Wise of William R. Hough & Co. Although the interest rate through the state program is somewhat higher, Wise said, that is canceled out by the high administrative costs charged by Fannie Mae, Pasco Woods' second choice for a "lender." "The Fannie Mae structure is very document intensive," Wise told county commissioners. The County Commission unanimously agreed to let its housing finance authority act as a lender. (*St. Petersburg Times*, 3/24/99)

Fannie Expands its Technology Reach to Consumers and Hyperlinks its Website to Another Public Library System

- Fannie announced that it has hyperlinked its consumer website, HomePath.com, to yet another library system, the Columbia, MO library system. As we have noted in previous *GSE Reports*, Fannie claims it is now hyperlinked to over 360 public library systems. Following a Homebuying Seminar where consumers are taught about Fannie Mae-specific products, Mayor of Columbia, MO, Darwin Hindman and Bill Brown, Director of Fannie's Kansas City Partnership Office will provide information about the Columbia Library's new "Home-Buyer Information Center" which will feature Fannie's website, HomePath.com. (*Fannie press release*, 3/23/99)

Fannie's Recent Swap which Allowed Holders of Fannie's Non-Benchmark Debt to Swap \$15 Billion of Non-Benchmark Debt for Fannie's Benchmark Notes was the Largest Non-Government Security in the Market – Exceeds the Volume of Fannie's Previous Largest Benchmarks

Analysts Expect to See More Swap Offers from GSEs

The Swap Reportedly Lowered the Interest Expenses and Taxes for Fannie, While Avoiding the Hit to Earnings Per Share

Fannie's Exchange Offer was Also the First to Make Use of A Recent IRS Guideline on Exchange Offers that makes the Offer Even More Attractive for Issuers (in this case, Fannie) and Investors

- As reported in the March 19 *GSE Report*, Fannie announced on March 10 that it offered holders of its non-benchmark debt the option of swapping their holdings for its five-year Benchmark Note. (Benchmark Notes are marketed as alternative to Treasuries.) The swap applies to holders of just over \$15.06 billion of Fannie's non-callable, US dollar denominated medium-term notes, global bonds and debentures. Investors taking part in the swap will receive holdings of 5.125% Benchmark Notes maturing in February 2004. Fannie has \$4 billion outstanding in Benchmark Notes and in addition to the exchange, it said it would reopen the issue to add at least another \$2 billion. The exchange offer applies to 71 specific issues of Fannie's outstanding debt with maturities ranging between June 2002 and March 2006.
- Fannie announced on March 26 the final results of its \$15 billion exchange, stating that more than 40% of the securities eligible for exchange were tendered by existing holders and that the issue now totals \$12.67 billion. The size of the security will now reportedly far exceed the volume of Fannie's previous largest Benchmarks, which stand at \$9 billion. The issue "is now the largest

non-government security outstanding in the marketplace, and is close in size to the current on-the-run, five-year U.S. Treasury Note,” stated Linda Knight, Fannie’s Senior Vice President and Treasurer. *Euroweek* noted that the swap offer is confirmation by Fannie to the market that all of its non-callable term funding in the dollar market will from now on be concentrated on its Benchmark Notes.

Analysts Expect to See More Swap Offers from GSEs

- Fannie said it is concentrating on the current exchange and has no immediate plans to announce another debt exchange, though it wouldn’t rule out the possibility at some point. “If investors want to consolidate their old issues into a larger, more liquid issue, then we will consider similar exchanges in the future, but we have no current plans,” said Hal Gann, Managing Director of Finance and Tax at Fannie Mae. Other agencies reportedly would not comment to *Dow Jones* or weren’t looking to bring a large exchange offer to the market. A Freddie spokesman declined to comment, while a finance official at the FHLBank System ruled out an exchange offer similar to Fannie’s. “It probably does not fit our liability portfolio to do an exchange offering the way it might some of the other agencies,” said Ed Means, a FHLBank Deputy Managing Director.

The Swap Reportedly Lowered the Interest Expenses and Taxes for Fannie, While Avoiding the Hit to Earnings Per Share

- According to an article in *Barron’s Online* by Jacqueline Doherty, corporations like Fannie are using bond exchange offers to lower their interest expense and taxes, while avoiding the hit to earnings per share that the exchanges once entailed. Reportedly, companies used to have a difficult time getting rid of high-coupon non-callable debt which could leave the debt outstanding, or have the company pay a fee of about five points in price to induce investors to tender its securities. Then after the company paid the tender, it would sell new, lower-coupon bonds, which entailed an underwriting fee. Doherty notes that these deals did result in nice tax deductions since companies could consider the premium above par they had to pay to tender the old bond at a deductible loss, however, the benefit was offset by the requirement to take a one-time write-off under old accounting rules and the write-off could cut into earnings which no shareholder company likes to do. Doherty notes that the rules changed when in August 1997 an arm of the Financial Accounting Standards Board ruled that under certain conditions companies don’t have to take the write-off, if a company persuades bondholders to exchange their old bonds for new bonds. Paul Galant, Head of Financial Engineering at Donaldson Lufkin & Jenrette noted that swap exchanges offer other benefits such as eliminating the need to raise new money and pay underwriting fees. In addition, market players stated that companies usually only need to pay up only about 1 ¼ points if they agree to exchange their bonds, instead of the five points they would have likely had to pay in a tender offer. Doherty notes that, all in all, the new exchange offers a much less expensive proposition and the company can still take the tax deduction and lower interest expense.
- Doherty notes that there is currently a lot of activity in bond exchanges because there is a proposal in President Clinton’s FY 2000 budget that would eliminate the new financing strategy. The proposal reportedly would require companies to spread the tax benefit over the life of the new bonds instead of taking it all at once. Reportedly, there are few tax experts that believe the proposal will be adopted, however, many companies are deciding to hit the market with exchanges just to make sure they don’t miss an opportunity.

Fannie’s Exchange Offer was Also the First to Make Use of A Recent IRS Guideline on Exchange Offers that makes the Offer Even More Attractive for Issuers (in this case, Fannie) and Investors

- A *Dow Jones-Capital Markets* article by Joe Niedzielski noted that Fannie's exchange offer was the first to make use of a recent tax guideline issued by the Internal Revenue Service. Niedzielski reports that the IRS Guideline, known as a "revenue procedure" – regarding the tax treatment of two or more outstanding debt instruments with debt instruments from a new issue – was issued earlier this month. Niedzielski notes that under the new tax guideline, essentially, both the issuer and investor can report gains or losses on the debt exchange over the term of the debt instrument, in this case, 5 1/8s of February 2004, rather than immediately "We designed this exchange so that all 71 bonds fit the revenue procedure," said Hal Gann, Fannie's Managing Director of Finance and Tax. From a psychological perspective, "it probably makes everybody in the transaction more comfortable that it's a reasonably tax neutral event," said Jim Vogel, Senior Vice President at First Tennessee. (*Barron's Online*, Jacqueline Doherty, 3/29/99; *Bloomberg News*, 3/10/99; *Dow Jones – Capital Markets Report*, Joe Niedzielski, 3/17/99, 3/19/99; *Euroweek*, 3/12/99, 3/26/99; *Fannie press release*, 3/10/99; *Financial Times*, Vincent Boland, 3/11/99; *National Mortgage News website*, posted 3/10/99)

Fannie's Technology Partner, Finet Holdings Corp., Names a New CFO and Senior VP (Finet Owns and Operates iQualify.com, the Website that Allows Consumers Direct Access to Fannie's Automated Underwriting Technology Systems)

- Finet Holdings Corp. named Gary Palmer, Chief Financial Officer and Michael Brown, Senior Vice President of Special Markets Lending. Palmer, who has been Finet's acting CFO since December, will report to CEO Mark Korrell. Brown will oversee the operation of Coastal Federal Mortgage and Monument Acceptance Corp, both subsidiaries of Finet. "As mortgage lending on the Internet continues to grow, we have found it necessary to significantly expand our capacity on both the East and West coasts in order to handle the influx of business generated from our websites, including iQualify.com, Finet.com, and the Finet Finance Center," Brown stated. Brown was most recently West Coast Regional Manager for MCA Mortgage Corp. and previously held senior positions with Unicor Mortgage, Industry Mortgage, and Advanta Mortgage Corp. (*National Mortgage News website*, posted 3/22/99)

Fannie Tops \$1 Billion in Business Using Actual/360 Payment Schedules through Fannie's Delegated Underwriting and Servicing/MBS Product – Fannie Notes that a Borrower Using this Actual/360 Method, will Pay More Interest on an Annual Basis than Traditional 30/360 Method

- Fannie announced that it has completed more than \$1 billion in multifamily mortgage lending through the Actual/360 option in its Delegated Underwriting and Servicing/MBS (DUS) product. The option was first introduced in May 1998 and according to Fannie, the Actual/360 option, which is available on loans of 10 years or less, gives DUS lenders the ability to offer borrowers a different payment schedule than normal DUS loans on the traditional 30/360 method. Fannie also claims that the Actual/360 option can offer borrowers lower coupon rates, less amortization, and more loan dollars than the 30/360 method. However, Fannie notes that a borrower using the Actual/360 method will pay more interest on an annual basis than the 30/360 method, assuming the same interest rate. (*Fannie press release*, 3/25/99; *National Mortgage News website*, posted 3/26/99)

Fannie Further Expands its Political Reach by Including Federal and State Officeholders in their Press Conferences and Press Releases and Increasingly Using their Partnership Offices (currently 35 offices - another added in Bay Area of San Francisco, CA) in Press Events

Senator John Edwards (D-NC), Cong. David Price (D-NC), Mayor of Durham, and Duke Blue Devil Basketball Coach and Former Duke University Players – (Fannie Provides Financing for High-End Rental Apartments & Commercial Space)

- Fannie announced a project through Fannie's American Community Fund to renovate five former historic tobacco warehouses in downtown Durham, North Carolina into 247 loft-style apartments and 31,000 square feet of commercial space called West Village. (All of the above listed people participated in the press conference). The \$36.5 million project is reportedly being divided between the following parties - \$23 million in mortgage financing guaranteed by HUD; \$7.9 million from Fannie and \$5.6 million from the partners and their friends and family. The loft apartments will reportedly be renting for around \$800 to \$850 a month. Two of the former Duke University basketball players, Christian Laettner and Brian Davis are building two penthouse apartments for themselves with a rooftop patio and a half-basketball court that will divide the apartments from the main office of their business. (*Wall Street Journal*, 3/24/99; *Fannie press release*, 3/15/99)

Senator Richard Bryan (D-NV), Nevada State Treasurer and Reno Mayor

- Senator Richard Bryan (D-NV), State Treasurer Brian Krolicki and Reno Mayor Jeff Griffin joined Fannie on March 20 to announce that Fannie exceeded its initial five-year \$5 billion HouseNevada investment plan. As part of the program, Fannie purchased a \$4 million tax-exempt bond to allow the city of North Las Vegas to greatly expedite the relocation process for families living in the Windsor Park subdivision, whose homes are being destroyed by ground upheaval due to soil subsidence. (Fannie press release, 3/30/99)

Senator Barbara Boxer (D-CA), Cong. Barbara Lee (D-CA), Oakland Mayor Jerry Brown

- Senator Barbara Boxer (D-CA), Congresswoman Barbara Lee (D-Ca), and Oakland Mayor Brown participated in a Fannie Mae press release announcing the success of Fannie's "HouseOakland" program. As an outgrowth of "HouseOakland," Fannie announced it opened a new Bay Area Partnership Office - its 35th partnership office. (*Fannie press release*, 3/29/99; *Associated Press*, 3/31/99)

Senator Rod Grams (R-MN), Minnesota Governor Ventura, Cong. Bruce Vento (D-MN) and Cong. Martin Sabo (D-MN), St. Paul Mayor, and Minneapolis Mayor

- Fannie announced that Elizabeth Harshfield, Senior Vice President of Fannie's Midwestern Regional Office joined Minnesota Governor Jesse Ventura, Senator Rod Grams (R-MN), Cong. Bruce Vento (D-MN), Cong. Martin Sabo (D-MN), St. Paul Mayor Norm Coleman, and Minneapolis Mayor Sharon Sayles Belton to announce a partnership spearheaded by the Home Ownership Center of Minneapolis and St. Paul with the support of Fannie. The press conference was held at the Minnesota Children's Museum in St. Paul.

Cong. Dave Weldon (D-FL) and Mayor of St. Cloud, FL – Fannie Begins an Underwriting Experiment

- Fannie issued a press release and held a press conference with Cong. Dave Weldon and St. Cloud, FL Mayor Glenn Sangiovanni to announce the grand opening of Cross Creek Estates, a community which includes 135 single family homes priced between \$84,000 and \$99,000. Fannie approved a \$3 million underwriting experiment, under which lenders only require borrowers to pay a 2% down payment and no mortgage insurance if the mortgage does not exceed 80% of the value of the property. Borrowers using the down payment and closing costs assistance must complete a pre-purchase and post-purchase housing counseling program. Fannie will purchase the first mortgage loans originated by Federal Trust and AmSouth. (*Fannie press release*, 3/30/99)

Cong. Mac Thornberry (R-TX)

- Fannie issued a press release to announce a \$5.5 million mortgage revenue bond agreement between Fannie and the Amarillo Housing Finance Corporation. Cong. Mac Thornberry (R-TX) stated in the press release that "I commend the Amarillo HFC and Fannie Mae for working together to help more families buy their own homes." Fannie purchased the \$5.5 million of tax-exempt mortgage revenue bonds issued by the Amarillo HFC. The bond proceeds will be made available on a first-come, first-served basis to borrowers, providing financing for 28-year, fixed-rate mortgages with an interest of 6.45%. Additionally, homebuyers will also receive a grant of 3% of the amount of their first mortgage which can be applied toward downpayment and closing costs. (*Fannie press release*, 3/15/99)

Cong. Chet Edwards (D-TX)

- Fannie announced an agreement with the Heart of Texas Housing Finance Corporation (HFC), whereby, Fannie will purchase \$13.75 million of tax-exempt mortgage revenue bonds issued by the HFC. The bond proceeds will be used to assist with down payment and closing costs for borrowers. A statement by Cong. Chet Edwards (D-TX) was included in the press release. (*Fannie press release*, 3/18/99)

Cong. Kevin Brady (R-TX)

- Fannie announced an agreement with the Montgomery County Housing Finance Corp. (HFC), whereby, Fannie will purchase \$9.97 million of tax-exempt bonds issued by the HFC. The bond proceeds will be used to assist with down payment and closing costs for borrowers. A statement by Cong. Kevin Brady (R-TX) was included in the press release. (*Fannie press release, 3/18/99*)

Cong. Merrill Cook (R-UT)

- Fannie announced that it would join Cong. Merrill Cook (R-UT) and other mortgage industry participants in a homebuying seminar for local families. Statements by Cong. Merrill Cook (R-UT) were included in the press release. (*Fannie press release, 3/24/99*)

Cong. Clifford Stearns (R-FL)

- Fannie issued a press release announcing that it had formed a partnership with the Clay County Housing Finance Authority (HFA). The Clay County HFA issued \$42 million single-family, tax-exempt mortgage revenue bonds and Fannie has agreed to purchase \$4.4 million of the tax-exempt bonds. The proceeds are available through 18 local mortgage lenders to provide low interest mortgage funds for qualified borrowers. Fannie also purchased a \$250,000 Down Payment Assistance Investment Note from the Clay County HFA whose proceeds will be used to make second mortgages available to low- and moderate-income residents in Clay County. A statement by Cong. Clifford Stearns (R-FL) was included in the press release. (*Fannie press release, 3/17/99*)

Cong. Gene Taylor (D-MS) in Housing Symposium

- According to a Fannie press release, Cong. Gene Taylor (D-MS) joined representatives of Fannie, local lenders, Realtors, developers and community leaders to discuss the creation of residential housing in central business districts in Biloxi, MS in a Housing Symposium on March 30. (*Fannie press release, 3/29/99*)

Cong. Kenny Hulshof (R-MO) and Mayor of Columbia, MO

- Cong. Kenny Hulshof (R-MO) and Mayor Darwin Hindman joined Fannie Mae in announcing an affordable homebuying seminar for local families. As part of the seminar, consumers will be taught about Fannie-specific products such as the Fannie's Flexible 97 (we have noted in previous *GSE Reports* - there are private institutions that offer lower cost products for borrowers). (*Fannie press release, 3/23/99*)

Mayor of Irving, TX

- Fannie issued a press release announcing a \$3.5 million mortgage revenue bond agreement with the Metropolitan Housing Finance Corporation. The Mayor of Irving, Morris Parrish, issued a statement for the press release. Fannie purchased the \$3.5 million of tax-exempt mortgage revenue bonds whose proceeds will be used on a first-come, first-serve basis to qualifying homebuyers. (*Fannie press release, 3/12/99*)

Fannie Names New Members to its National Advisory Council

- Fannie announced 18 new members to its National Advisory Council (Fannie's press release said there were 17 new members, however, the press release named 18 new people). According to a Fannie press release, Council members meet three times a year with Fannie's Senior Management to advise the corporation on issues affecting the housing and mortgage finance industry. The council, formed in 1971, has 41 members. The 1999 National Advisory Council will be chaired by Charles Ruma, President of Davidson Phillips Inc. Ruma is also the 1999 National Association of Home Builders President. The following new members will serve until December 2000:
 - (1) **Emily Annerino** – President of LHI Mortgage, Inc., and member of Home Builders Assoc. of Greater Chicago, the Mortgage Bankers Association, and the National Association of Mortgage Brokers
 - (2) **Mary Frances Burlison** – President of Ebby Halliday Realtors – she serves as a director of the Texas Association of Realtors and is a member of the National Association of Realtors Board of Directors
 - (3) **Honorable Emanuel Cleaver II** – Mayor of Kansas City, MO.
 - (4) **John Courson** – President and CEO of Central Pacific Mortgage Corp. – he is currently a member of the Mortgage Bankers Association Board of Directors, chairman of the MBA Residential/Single Family Board of Governors, and Chairman of the MBA Mortgage Reform Task Force

- (5) **Dennis Cronk** – Broker/Owner of Waldvogel, Poe & Cronk Real Estate Group – he serves as the 1999 President-Elect of the National Association of Realtors
- (6) **Timothy Eller** – Chairman and CEO of Centex Homes and Executive Vice President of Centex Corporation
- (7) **Virginia Ferguson** – Co-Owner and Broker of Heritage Valley Mortgage – currently serves as a director of the National Association of Mortgage Brokers and past Pres. of the California Association of Mortgage Brokers
- (8) **Charles Foster** – Chairman & CEO of Land America Financial Group – he is President-Elect of the American Land Title Insurance Company
- (9) **Robert Gullede** – Chairman, President & CEO of Citizens' Bank and Chairman of the Board of Directors of Citizens' Capital Corp. – member of Board of Directors of the Independent Bankers Association of America and served 4 years in the AL State Sen. and 4 years as the Superintendent of Banks for the State of Alabama
- (10) **Joseph Haskins, Jr.** – President & CEO of the Harbor Bank of Maryland – Chairman of the Maryland Economic Development Commission, and a Member of the Mayor's Business Advisory Council, and of the Independent Bankers Association of America
- (11) **General Robert Herres** – Chairman & CEO of USAA - last military assignment was as Vice Chairman of the Joint Chiefs of Staff
- (12) **Thomas H. Mann** – President & CEO of GE Capital Mortgage Corp.
- (13) **Alden McDonald, Jr.** – President & CEO of Liberty Bank & Trust Company
- (14) **Robert Mitchell** – FVP of National Assoc. of Home Builders and Chairman & CEO of Mitchell BestGroup
- (15) **R. Layne Morrill** – President of Shepherd of the Hills, Realtors – Immediate Past President of the National Association of Realtors
- (16) **Richard Roberts** – Commissioner of New York City's Department of Housing Preservation and Development
- (17) **Richard Swanson** – President & CEO of Continental Savings Bank – Serves on Residential/Single Family Board of Governors of the Mortgage Bankers Association
- (18) **James Witherow** – President and CEO of FT Mortgage Companies – Member of the Board of Governors of the Mortgage Bankers Association (*Fannie press release, 3/22/99*)

Fannie Provides another REIT with a Credit Facility

- United Dominion Realty Trust Inc. announced it has closed on the first part of a \$200 million revolving credit facility with Fannie Mae. The financing is for an initial term of five years, bears interest at a floating rate which can be fixed for periods of up to 270 days, and can be extended for an additional five of ten years at the company's discretion. The real estate investment trust (REIT) used the loan proceeds to repay a \$91 million secured bridge loan bearing interest at 7.24%. Several of the company's apartment communities secured the credit facility. (*Dow Jones Newswire, 3/18/99*)

Fannie Partners with Bank of America to Fund Housing for Low-Income Chicagoans

- Fannie and Bank of America have teamed up to invest in the low-income rental housing market in the City of Chicago through the Apollo American fund – a tax credit equity. Fannie will invest \$19 million in the fund to provide rehabilitation and new construction financing aimed at creating affordable housing for more than 770 families. Bank of America will invest \$5 million and provide a \$12.5 million line of credit to the fund. (*Fannie press release, 3/17/99; Mortgage Marketplace-American Banker, 3/21/99; National Mortgage News website, posted 3/18/99*)

Fannie Provides Credit Enhancement for \$3.9 Million in Tax Exempt Bonds to Help Finance a Multifamily Affordable Rental Housing Complex

- Fannie issued a press release to announce that Fannie provided credit enhancement for \$3.9 million in tax-exempt bonds issued by the Housing Finance Agency of Orange County, Florida. The proceeds from the sale of the bonds will be used to finance the rehabilitation of a existing multifamily development that will provide affordable rental housing to families in Winter Park, FL.

ARCS Commercial Mortgage Corp. is the permanent lender for the development and will service the loan for Fannie. (*Fannie press release, 3/5/99*)

Fannie Claims it Played a Key Role in the 90s Housing Boom

- According to a press release and press conference by Fannie, the company played a key role in the 90s housing boom. The press conference was Fannie's fifth annual report on its "Trillion Dollar Commitment." (*PR Newswire, 3/15/99*)

Fannie Holds Several Events with NBA Teams

- As part of the their HomeTeam program, Fannie hosted events in the last few weeks with the San Antonio Spurs, Portland Trail Blazers, and the Washington Wizards pro basketball teams. (Fannie Foundation press release, 3/22/99, 3/25/99/27/99)

Fannie Provides Home for Family of Seven Surviving Octuplets

- Parents of the seven surviving Houston, TX octuplets received a new home valued at \$274,000 courtesy of Fannie. Fannie donated the six-bedroom, 5,384 square foot house to the family. (*Associated Press, 3/26/99*)

PepsiCo Nominates Fannie's Chairman to Board

- PepsiCo nominated Fannie Chairman Franklin Raines to its board. PepsiCo said elections for its board would take place at its May 5 annual meeting. (*Dow Jones Newswire, 3/25/99*)

Fannie Executive Put to Task by Conservatives

- In unreported news, at a recent ad-hoc meeting of conservative Capitol Hill staff, conservative think-tank representatives, conservative press, and others, Arne Christenson, former chief of staff to former House Speaker Newt Gingrich and now a Fannie Mae executive, was taken to task by the conservatives for the liberal giving programs of the Fannie Mae Foundation, Fannie's Mae's special tax status, and the fact that Fannie Mae's senior management are liberal Democrats. Christenson described OFHEO as 117 bureaucrats who regulate just Fannie Mae and Freddie Mac, and was seeking the group's support in preventing the OFHEO regulations from being implemented.

Freddie Mac

IRS Seeks \$76.7 Million in Back Taxes from Freddie Mac

- According to an article in the *Washington Business Journal*, the IRS is seeking \$76.7 Million in back taxes from Freddie Mac, stemming from the years following the company's switch in 1985 to a private-sector company. Freddie reportedly filed a petition on February 26 asking the US Tax Court to throw out the IRS's argument that it owes \$36.6 million in taxes from 1985 and \$40.1 million from 1986. Freddie also argued that, far from owing anything, Freddie overpaid taxes in 1985 and 1986 by \$22 million. The IRS denies Freddie's claim. The total amount in dispute is \$98.7 million.
- Freddie did not make comments for the article. The IRS stated that it was their policy not to comment on pending cases. According to the article, if the case is not settled by negotiation (which the article notes usually occurs in tax court), then the case will be tried in Washington.
- The details of the case were reported as follows:
 - Freddie declared taxable income of \$20,862,143 in 1985 – the IRS claims the figure should be \$104,134,544. Freddie declared taxable income of \$26,938,082 in 1986 – the IRS claims the figure should be \$114,181,184.
 - Before 1985, Freddie was a tax-exempt company. In 1985 and 1986 returns, Freddie sought to amortize the value of some assets and deduct those amounts in calculating what it owed. The amortizations (\$58.1 million for 1985, \$56.6 million for 1986) are what the IRS questions. Without the amortizations, the IRS calculates that Freddie income taxes increased from \$9,592,936 to \$46,216,631 in 1985 and for 1986, the taxes increased from \$12,413,021 to \$52,524,148.
 - The tax deductions sought by Freddie were made on customer service assets, valued at \$600 million and broken out into pieces of \$60 million over 10 years. The intangible asset included debts; software information systems; rental contracts; information on the institutions that regularly sold mortgages to Freddie; and the roster of Freddie's "specialized professionals" with unique skills. The IRS denied the deductions on the grounds that Freddie had no "basis" in them.
 - The deductions are the grounds for Freddie's argument that it overpaid taxes – Freddie claims it merits a refund of the \$9.6 million and \$12.4 million in taxes it already paid in 1985 and 1986. (*Washington Business Journal*, 3/12/99)

Warren Buffet's Annual Report Notes that he Sold a Number of Freddie Mac Shares

- In his annual letter to Berkshire Hathaway's shareholders, Berkshire appeared to have slightly lowered its stake in Freddie Mac. "We trimmed or substantially cut" a number of the portfolio's holdings, Buffet's letter notes without elaboration. According to the shareholder letter, the company held 60,298,000 Freddie Mac shares as of 12/31/98. As we reported in the December 18, 1998 *GSE Report*, Warren Buffet's Berkshire Hathaway revealed holding 63,977,600 shares

(reflecting no changes since second quarter 1997) in Freddie Mac and 6,558,000 (a reduction of 206,200 shares since second quarter 1997) in Fannie Mae according to a confidential Form 13F covering the third quarter of 1997. (*Newstraders*, 12/17/98; *Wall Street Journal Interactive Edition*, 3/15/99; *Warren Buffet's Annual Letter to Berkshire Hathaway Shareholders*, 3/1/99)

Federal Home Loan Banks

Fannie Increases its Criticisms of FHLBank System's Mortgage Partnership Finance (MPF) Program – Ironically, While Fannie Criticizes OFHEO's Proposed Rule for Increasing Capital Requirements on Fannie, Fannie Lobbies Hard to Convince Congress and Other Regulators that a Competitor (FHLBank System) Has Insufficient Capital

Fannie writes FDIC Comparing the Risk of FHLBank's New Programs to S&L Crisis – Meanwhile, the FHLBank's new MPF Program is Becoming a Real Competitor to Fannie & Freddie

One of the FHLBanks is Reportedly Considering Asking the Justice Department's Antitrust Division to Look into Fannie's Activities to See if any Anticompetitive Behavior by Fannie

- According to the *Washington Post*, some economists and government officials stated that they found Fannie's efforts to change OFHEO's proposed risk-based capital rule on Fannie and Freddie "ironic," given that Fannie has also been lobbying hard to convince Congress and other regulators that the increasing secondary market competitor to Fannie – the FHLBank System – has insufficient capital. In a March 18 letter to Peter Knight, Director of Legislative Affairs at the Federal Deposit Insurance Corp. (FDIC), Arne Christenson, Fannie's Senior Vice President for Regulatory Policy, wrote that new ventures in which FHLBanks invest directly for portfolio and provide letters of credit have injected a new risk into their operations. Christenson wrote: "We think the current situation bears some disturbing similarities to the S&L crisis of the late 1980s," which cost taxpayers several hundred billion dollars. "Institutions with thin capital are expanding into areas of higher risk, when they have little experience managing such risk." John Connor at the *Wall Street Journal* and *Dow Jones Newswire* reported that over 20 pages of material elaborating on Fannie's arguments were attached to the letter and were a sequel to a meeting between senior Fannie and FDIC officials.
- Most of the criticism of the FHLBanks by Fannie was aimed at the FHLBank's MPF Program – the new direct competitor to Fannie and Freddie in the secondary market. The MPF program, first developed by the FHLBank of Chicago provides thrift and commercial bank lenders with an alternative to selling fixed-rate home loans to Fannie and Freddie. The program allows FHLBanks to purchase mortgage loans originated by member financial institutions.
- John Connor with the *Wall Street Journal* and *Dow Jones Newswire* wrote extensively about Fannie's letter to the FDIC. Reportedly, Fannie's Christenson wrote in his letter that traditionally the FHLBank's main functions have been to provide low-cost loans, called advances, to member mortgage-lending institutions and that "the Federal Home Loan Banks have a capital structure that didn't cause much concern while they carried out their traditional role of providing over-collateralized advances to member institutions." He noted, however, that things are different

now in light of the FHLBank's new ventures. Christenson stated that "these transactions are beginning to proliferate, exposing federally regulated institutions to risk without adequate capital." The letter stated that the FHLBank System is "expanding its powers and activities with assets and risks held by the FHLBanks, rather than the members," and that "the capital structure of the FHLBanks, and perhaps many other aspects of running the system, is not designed for this dramatic expansion." The letter added, "To take on real risks, the FHLBs must have real capital."

One of the FHLBanks is Reportedly Considering Asking the Justice Department's Antitrust Division to Look into Fannie's Activities to See if any Anticompetitive Behavior by Fannie

- A FHLBank System Spokesman stated that Fannie is trying to squash the MPF by "spreading misinformation" to federal regulators. A FHLBank Spokesperson recently noted that the FHLBanks' permanent capital now exceeds \$900 billion and the assets of the MPF total only \$1.1 billion. In contrast, the Spokesperson noted that Fannie only has \$16 billion in equity to capitalize \$415 billion in assets held in its mortgage portfolio. FHFB Chairman Bruce Morrison stated that "What this boils down to is Fannie Mae saying it favors competition but is somehow worried that low-risk MPF loans from Federal Home Loan Banks with higher capital are somehow unsafe." Morrison further stated that "If you believe that, I have a great deal on a bridge in Brooklyn." In his articles, John Connor noted that people familiar with the matter noted that one FHLBank is reportedly so upset over Fannie's recent activities that is considering asking the Antitrust Division of the Justice Department to look into the matter to see if there is anticompetitive behavior. "Give me a break," was the response of one Fannie official.
- Fannie's Spokesman John Buckley denied that Fannie was afraid of competition stating that "nothing could be further from the truth." But he added that "if the Federal Home Loan Banks want to expand into wholly new areas, they should have a real regulator, real capital and real percentage-of-business goals just like Fannie Mae." (*Wall Street Journal*, John Connor, 3/29/99; *Dow Jones Newswire*, John Connor, 3/26/99; 3/29/99; *Washington Post*, Kathleen Day, 3/27/99; *Bloomberg News*, 3/29/99; *Mortgage-Backed Securities Letter – American Banker*, 3/22/99; *National Mortgage News website*, posted 3/29/99;)

The First Lender in TX to use the FHLBank's MPF Program (Bank United) and the National Association of Home Builders File Amicus Briefs with an Appeals Court Defending the MPF Program – Bank United Stated that the MPF Program allows Member Banks and Thrifts to Avoid the Higher Credit Guarantees Charged by Fannie & Freddie

- According to Brian Collins with *National Mortgage News*, the first lender in Texas to use the FHLBank System's MPF program (Bank United) and the National Association of Home Builders filed amicus briefs in the US Court of Appeals for the 5th Circuit defending the MPF program.

Bank United

- According to the article, Bank United filed an amicus brief stating that there was "no basis" to arguments by the Texas Savings and Community Bankers Association and others that the MPF program represents "unfair competition" to FHLBank Members or that the FHLBanks are engaged in retail lending. "It defies business logic to contend that institutions like Bank United, which participate in the MPF program voluntarily, do so to jeopardize their competitive position in the mortgage market," according to the amicus brief. Bank United noted that the MPF is "just another wholesale funding mechanism" that allows FHLBank members to be more competitive with other

retail lenders. “At the same time, the MPF program enables member institutions to avoid higher credit guarantee fees charged by Fannie Mae and Freddie Mac.” Bank United has completed one MPF transaction involving \$83 million in single family loans.

National Association of Home Builders

- According to Collins, the National Association of Home Builders also submitted an amicus brief in support of the MPF program arguing that the MPF program makes mortgages available to “more” borrowers who aren’t served by the traditional secondary market. “[I]t is essential that the program not be thwarted by an overly restrictive interpretation of the FHLBank Act proffered by parties that perceive themselves as competitors of the FHLBanks,” the Home Builders stated. (*National Mortgage News*, Brian Collins, 3/15/99)
- As reported in the March 5 *GSE Report*, the Justice Department and Freddie Mac have both filed amicus briefs. The Justice Department reportedly filed an amicus brief with the appeals court stating that the Federal Housing Finance Board was on solid legal ground when it approved the MPF Program. Freddie Mac filed a brief against the MPF program, stating that the FHLBank Act “nowhere indicates that the FHLBanks may purchase or invest in mortgages from any mortgage seller, let alone directly make mortgage loans as in the MPF program.” (*Dow Jones Newswire*, John Connor, 2/24/99)

Background on Case

- The Texas Savings and Community Bankers Association, Western League of Savings Institutions, World Savings Bank, Austin, World Savings and Loan Association, Oakland, CA, and Charter One Bank, a Cleveland-based thrift sued the Federal Housing Finance Board (FHFB) (the regulator of the FHLBank System) for approving the MPF program. The thrifts contend that the FHLBanks are engaged in retail lending, which is not permitted under their charter. The FHFB won in the US District Court for the Western District of Texas on June 25, 1998 when the Court found that the MPF pilot was permissible under the FHLBank Act. The federal judge, Sam Sparks, dismissed the case brought by the thrift groups and ruled that the FHFB did not exceed its authority. The thrift groups appealed Judge Sparks’ decision on July 30, 1998 to the US Fifth Circuit Court of Appeals. The Fifth Circuit reportedly is expected to render a decision later this year. Final briefs were reportedly due March 24 and both sides have asked for a hearing to present their argument before the circuit judges. (*Dow Jones Newswire*, 7/31/98; *National Mortgage News*, Brian Collins, 3/15/99; *National Mortgage News website*, posted 8/3/98)

<p>Treasury Secretary Rubin Criticizes the Non-Mortgage and Arbitrage Investment Activities of the FHLBank System – FHLBank Regulator Said He would Support any Investment Restrictions Placed on the FHLBanks as Long as it was Imposed on Fannie & Freddie as Well</p>

- According to *Dow Jones Newswire*, while speaking to reporters on March 19, Treasury Secretary Robert Rubin reiterated a Treasury and Clinton Administrative criticism that the FHLBank System is too heavily involved in arbitrage activities and not mortgage lending. Rubin stated that the FHLBank System “has now gotten to the point where it is the largest borrower in the country.” Rubin stated that it was up to Congress to decide how the FHLBanks can best serve its mission. Rubin further noted the FHLBank System “should use its low cost of borrowing to serve that purpose, not have a very large portfolio.”

- Responding to the criticism, the FHLBank has noted that it is not on a level playing field of capital with Fannie and Freddie. FHFB Chairman Bruce Morrison has stated that the government has a double standard when it comes to arbitrage. “The Treasury speaks volumes about arbitrage when they talk about the Federal Home Loan Banks, and nary a peep about arbitrage when they speak about Fannie Mae and Freddie Mac,” he stated. “I support any investment restriction to the Federal Home Loan Bank that is applied equally to Fannie Mae and Freddie Mac. You write it down, I’ll sign it.” (*Dow Jones Newswire*, 2/26/99; 3/19/99)

Addressing Criticisms about the FHLBank System’s Non-Mortgage and Arbitrage Investment Practices, the FHLBank System’s Regulator is Considering Requiring FHLBanks to Redeem Excess Capital Stock that is Often Used to Finance “Arbitrage” Investments

- The regulator of the FHLBank System, the Federal Housing Finance Board (FHFB) is considering requiring the FHLBanks to redeem excess capital stock that is often used to finance “arbitrage” investments. During a meeting of the FHFB on March 19, the FHFB adopted an advance notice of proposed rulemaking so that it can solicit public comments over the next 30 days to determine whether the banks should be required to unilaterally redeem members’ excess capital. At year-end 1998, the 12 FHLBanks reportedly held a combined \$22.8 billion in capital stock - \$2.8 billion (12.6%) of which exceeded the banks’ minimum capital requirements. FHFB Chairman Bruce Morrison stated that much of the extra capital on the FHLBank’s balance sheet is used for arbitrage activities, which Morrison opposes.
- The FHFB also unanimously voted to adopt an interim final rule that would prohibit FHLBanks from charging a fee to system members that want to redeem excess stock they may have in the bank. The interim final rule would reportedly nullify a plan by the FHLBank of San Francisco to start imposing a fee for banks that hold excess stock in a FHLBank March 31. Members that hold more stock than required to join the FHLBank System would have paid the fee. According to Morrison, the FHFB’s decisions during the March 19 meeting were designed to reduce the FHLBank’s dependence on market investments. “One of our prime goals, which is to refocus the assets of the banks on core mission assets, is explicitly undercut by the holding of excess stock,” Morrison stated.
- At issue, the FHLBanks do not want members to hold more than the minimum capital investment, because the FHLBanks must invest the excess capital. To join the FHLBank System, banks and thrifts must buy stock in one of the 12 FHLBanks and the amount purchased is dictated by the institution’s asset size. However, some banks and thrifts now hold more than the required minimum because they are smaller than when they bought the shares, or because FHLBank dividends have been paid in stock.
- According to the FHFB, mandatory redemption or imposing a fee on excess capital would add 12 basis points to the FHLBank of San Francisco’s quarterly dividend. The *American Banker* noted that there is a twist since five FHLBanks, including the FHLBank of San Francisco, pay dividends in stock rather than cash. Taxes are not owed on stock dividends until the stock is sold. According to Brian Smith, Director of Policy and Economic Research at America’s Community Bankers, for this reason, many banks’ and thrifts’ taxes would rise if their FHLBank paid its dividends in cash or forced them to redeem their excess stock. The article noted that the FHLBank of San Francisco wanted to let members continue to hold excess stock in exchange for a fee. The fee, according to Smith, would have still been lower than the taxes member banks and thrifts would have to pay.

- The FHFB also adopted a final rule during the March 19 meeting that would allow Bank members to use government-insured loans (even if they are in default) and Ginnie Mae securities as collateral for advances. The final rule also clarified that FHLBanks may accept as collateral shares of mutual funds that invest in mortgage-backed securities or qualifying government securities. (*American Banker*, David Harrison, 3/22/99; *National Mortgage News website*, posted 3/22/99)

House Leadership Gives Commerce Committee a May 14th Deadline to Vote on House Financial Services Modernization Bill (H.R. 10) which Contains Five FHLBank Expansion Provisions

- The House Republican leaders have told the Commerce Committee that May 14th is the deadline for a vote on the House's Financial Services Modernization Bill (H.R. 10). As reported in previous *GSE Reports*, H.R. 10 contains the following FHLBank expansion provisions: (1) makes thrift membership voluntary; (2) allows collateralized advances for institutions with less than \$500 million in assets; (3) changes financing from fee-based system to flat rate by converting the annual \$300 million REFCorp. obligation to 20.75% of earnings; (4) reduces FHFB control of day-to-day FHLBank operations; and (5) establishes new capital structure based on two classes of stock. The House Banking Committee approved H.R. 10 on March 11 by a 51-8 bipartisan vote. The House Banking Committee version must also pass the Commerce Committee. Cong. Michael Oxley (R-OH), Chairman of the House Commerce Subcommittee on Finance and Hazardous Materials, reportedly stated that his Subcommittee will hold hearings on the bill when Congress returns from Congressional recess in April, and he anticipates that a bill will pass out the Commerce Committee "no later than the end of April, beginning of May." (*BNA Daily Report for Executives*, 3/23/99; 3/26/99; *National Mortgage News*, 3/15/99)
- The Senate Banking Committee passed its version of financial services modernization on a party-line vote of 11-9 on March 4. As reported in the February 19th *GSE Report*, when Senate Banking Committee Chairman Phil Gramm (R-TX) introduced his original draft financial services modernization bill, he was still considering whether to include FHLBank provisions in the bill. In the updated version of the bill, approved by the Senate Banking Committee, Senator Gramm included FHLBank language making thrift membership voluntary, allowing collateralized advances for institutions with less than \$500 million in assets, converting the annual \$300 million Resolution Funding Corp. obligation to a percentage of FHLBank earnings, and instructing the General Accounting Office (GAO) to conduct a study of the FHLBank System capital structure. Senate Majority Leader Trent Lott (R-MS) announced that he would like the Senate to take action on its version of financial services modernization during the first two weeks of May. (*BNA Daily Report for Executives*, 3/18/99; *National Mortgage News website*, posted 3/2/99)

National Mortgage News Runs Editorial on FHLBank System's MPF Program – Notes that MPF Program is First Competitive Force in the Secondary Market to Establish Itself in Quite a While

- Mark Fogarty, Editorial Director of *National Mortgage News*, wrote an editorial on the *National Mortgage News website* on the FHLBank System's MPF program, entitled "It Takes a GSE." Fogarty wrote that Alex Pollock, Chairman of the FHLBank of Chicago (the creator of the MPF program) recently spoke of the MPF's program success during a keynote address to the Faulkner & Gray Mortgage Funding Conference. Fogarty thought that the delivery of Pollock's speech could not have been more timely since the "crescendo of outcries about the mortgage duopoly of Fannie

and Freddie Mac was reaching fever pitch.” Pollock’s basic challenge to the competitive threat of Fannie and Freddie is “it takes a GSE to compete against a GSE.”

- Fogarty noted that the volume of business for the FHLBanks in the MPF is “puny” compared to the volume of business for Fannie and Freddie – MPF passed \$2 billion in commitments and \$1 billion in fundings. However, Fogarty points out that with \$388 billion in assets, the FHLBank System is “formidable financing entity, well above Freddie’s \$263 billion and in the same league as Fannie’s \$455 billion.” And, Fogarty notes that “it’s clear that there’s some momentum building among the bank and thrift members of the FHLBs eligible to be in the program.”
- Fogarty concluded by stating, “the sailing hasn’t been entirely smooth for the MPF. Nevertheless, it has managed to hoist its sale, no little accomplishment in the face of such formidable competitors as Fannie and Freddie. Whether you think the MPF is ‘conceptually elegant,’ as Mr. Morrison [FHFB Chairman Bruce Morrison] does, or a flouting of the FHLBs’ charter, as others do, it stands as the first competitive force in the secondary market to establish itself in quite a while, lending credence to Mr. Pollock’s credo: It takes a GSE to compete with a GSE.” (*National Mortgage News* editorial, Mark Fogarty, *National Mortgage News website*, 3/9/99)

President of America’s Community Bankers Responds to March 10 *Washington Post* Op-Ed which Referred to GSEs’ (Most Specifically the FHLBanks) Arbitrage Investments as “A US Government Hedge Fund”

Original Op-Ed

- As reported in the March 19th *GSE Report*, an op-ed by David Ignatius appeared in the March 10 edition of the *Washington Post*. Ignatius detailed the tremendous market advantage that GSEs enjoy over their private sector counterparts, and in particular, he focused on the “arbitrage” strategies that allow the GSEs to “profit from the spread between the cheap money they can borrow as government-backed institutions and the higher rates they receive in the commercial money market.” **Ignatius likens this GSE arbitrage practice to a quasi-hedge fund operation.**
- Ignatius discussed a failed amendment offered during the House Banking Committee mark-up of H.R. 10 that would allow the FHLBank System to borrow even more money. Ironically, he notes that one of the primary opponents of the amendment was Fannie, which was worried about unfair competition. Fannie contends that since the FHLBank’s stock is owned by its 6,800 members, most of which are federally insured, it doesn’t have a normal “at risk” capital base. Fannie said it, in contrast, raises capital by selling shares to the public.
- The op-ed cited a letter from Treasury Secretary Robert Rubin in which Rubin was sharply critical of the FHLBanks System’s investment practices, stating that the FHLBank System has “fundamental problems.” Elaborating on this point, Rubin adds “with a total of \$350 billion in government-subsidized debt outstanding, it (FHLBanks) uses little of this debt to further its public purpose of expanding homeownership.” And he also calls for “curtailing the use of subsidized funds to make overnight money-market loans and hold a \$150 billion investment-arbitrage portfolio.” (*Washington Post*, Op-Ed, David Ignatius, 3/10/99)

America’s Community Bankers Response

- Paul Schosberg, President and CEO of the America’s Community Bankers, wrote a letter-to-the-editor on March 20 in response to Ignatius’ op-ed. Schosberg noted that Ignatius’ use of “daily

volume” as the barometer for debt issuance was “misleading” and ignored the fact that the FHLBanks are banks. “The US Treasury, with about \$3.7 trillion of public debt dwarfs the FHLBank system or any other single US player in the debt markets.” In fact, he points out that Fannie, by itself, “has a balance sheet as big as that of the 12 FHLBanks combined.”

- He also noted that the “FHLBanks do not inflate their balance sheets return from positions in arcane instruments, unlike the ill-fated Long Term Capital Management operation.” He points out that when a new member joins one of the FHLBanks, the member by law must purchase a prescribed amount of newly issued stock and until the new member borrows, the FHLBanks invest in safe domestic securities.
- Schosberg believes that the FHLBanks’ investment portfolio plays a “key role in assisting the system’s basic mission.” (*Washington Post*, 3/20/99)

Members of National Neighborhood Coalition Met with Council of FHLBanks to Press for Support of a Stronger Community Agenda by FHLBanks

- According to a press release by the National Neighborhood Coalition (NNC), the NNC met with the Council of FHLBanks (the trade association for 10 of the 12 FHLBanks) in Washington, DC on March 22 to urge Council Members “to be more responsive to pressing unmet housing and community development needs in low-income urban and rural America,” while expressing support for the role that the FHLBanks have taken in the past decade in affordable housing finance and community development lending. The NNC represents thousands of community, neighborhood, and faith-based organizations. The NNC requested the support of the Council in retaining the community-oriented seat on the FHFBS. The NNC co-hosted a three-hour session on March 8 with the FHFBS entitled the “Dialogue on the Federal Home Loan Bank System,” which reportedly drew nearly 70 community advocates to discuss current and future legislative, regulatory programs and directions of the FHLBanks. (*NNC press release*, 3/22/99)

FHLBank of Pittsburgh Announced New Appointments to Board of Directors

- The FHLBank of Pittsburgh announced several appointments to its Board of Directors. They are: Raymond R. Christman, Chairman; John T. Connelly, Vice Chairman; and J. Roger Glunt, and Ronald W. O’Donnell, Public Interest Directors. The FHFBS also announced that it appointed Catherine Baker Knoll as a new public/Community-Interest Director. (*Pittsburgh Post Gazette*, 3/18/99)

FHLBanks are Reportedly the World’s Largest Contributor to Habitat for Humanity

- A luncheon and press conference was held on March 30 in Atlanta, GA by the FHLBank System to announce a national building initiative in celebration of their 10-year affordable housing anniversary. Miller Fuller, Habitat for Humanity’s Founder was the keynote speaker for the luncheon. According to *PR Newswire*, the 12 FHLBanks have become the largest worldwide contributor to Habitat for Humanity, having donated \$39 million to help construct 7,000 houses over the past 10 years and that one in every four Habitat homes have been built with FHLBank dollars. In celebration of the 10-year anniversary of the FHLBanks AHP, they announced their contribution for 1999 – each FHLBank will help to build at least one house in its local area. (*PR Newswire*, 3/22/99)

Farm Credit System

GSEs' Benchmark Issues are Seeking to Replace Treasuries as Pricing Benchmarks – Farm Credit Banks Follow Fannie & Freddie's Lead and Begin to Issue Large Non-Callable Debt, Marketed as Alternatives to Treasuries

- According to a *Bloomberg News* article, at a time when the Treasury is selling less and less debt, as the booming economy produces budget surpluses, more investors are looking beyond the government securities market for a gauge of the cost of money. The article notes that AT&T Corp., MCI WorldCom Inc., Associates Corp. of North American, and Fannie and Freddie are just a few of the borrowers that have sold multibillion dollar debt issues in recent months. With shrinking Treasury debt, yields have fallen, lowering borrowing costs and prompting companies to sell securities in large enough amounts to have the potential to take on benchmark status. The article notes that as the pool of existing government debt gets smaller, and fewer issues are sold, it may grow increasingly hard for corporations and other borrowers to get a good grasp of current borrowing costs from the Treasury market alone. Fannie, Freddie, the FHLBank System and now, the Farm Credit Banks, have launched programs in the past year to sell large, easy-to-trade issues in a variety of maturities, which analysts, investors – and even the issuers themselves – predict could serve as pricing benchmarks. “It’s quite conceivable,” stated John The Losen, Vice President of Debt Marketing at Fannie. The Losen noted that Fannie is expected to sell \$130 billion of debt this year under its “Benchmark Note” program, making it second only to Treasury in terms of borrowing. Since the program was started in January 1998, Fannie has sold more than \$60 billion of securities.
- The article notes that “With their top debt ratings, large issue size and frequency of borrowing, investors said Fannie Mae and other government-sponsored enterprises may have the makings for a good pricing benchmark. These issues include some with maturities no longer sold by the government – such as three- and seven-year notes – that might provide a better gauge of borrowing costs for securities sold in that range, investors said.”
- “If Treasury supply was cut in half and we saw continuing growth in agency paper, that would be the only scenario where the use of Treasuries as benchmark might be threatened,” said David Olsen, Vice President on the Investment-Grade Syndicate Desk at J.P. Morgan. The article notes, however, that some analysts paint exactly that scenario. Debt of GSEs is being used when typically only Treasuries were used before. For example, Fannie’s Notes are replacing Treasury notes as a hedging tool by many traders and investors looking to offset other positions. (*Bloomberg News*, 3/26/99)

Farm Credit Banks

- The Federal Farm Credit Banks Funding Corp. announced on March 19 the launching of its Designated Bonds program. The Federal Farm Credit Banks sold its first issue of Designated Bonds on March 25 with a \$1 billion two-year offering and became the latest GSE to offer investors large, liquid offerings that provide an alternative to Treasuries. “We’ve been watching the successful development of the agency curve, thanks to Fannie, Freddie and others who have used this method for selling debt and have had great success,” said James Brickley, the Funding Corp.’s President and CEO. According to the Federal Farm Credit Bank’s Funding Corp., the issuance of Designated Bonds reflects a decision to consolidate certain of the System Banks’ term debt needs into large, non-callable, regularly announced issues. Designated Bonds will be offered through the

Federal Farm Credit Bank's consolidated systemwide bond program. The minimum initial principal amount of each new issue of Designated Bonds will be \$1 billion, while the minimum reopening will be \$250 million. The intent is to issue the Designated Bonds monthly, however the agency said actual financing will depend on its funding needs, market conditions, and investor interest. The Funding Corp. announced that future offerings of Designated Bonds will generally be within maturities of five years or less, and most likely center around the two-to-three year range.

- Reportedly, the deal is already three times oversubscribed, and most of the bonds could have been allocated overseas. The bonds were priced at 5 1/8s to yield 5.19%, for a spread of 24 basis points over Treasuries. They mature in April 2001. One driver of demand appeared to be the scarcity value of the paper since investors don't own the name, and some investors may have hit their limits on other agency issuers. (*Wall Street Journal*, 3/29/99; *Dow Jones Newswire*, 3/19/99; *Dow Jones – Capital Markets Report*, 3/25/99, 3/26/99)

Ginnie Mae

Fannie, Freddie, and Housing Industry Trade Groups Voice their Opposition to a Ginnie Mae Privatization and User Fee Proposal in the Senate Budget Plan

(Since a Privatized Ginnie Mae would No Longer Carry the Full Faith & Credit of the US Government, or Have the Implied Backing Provided other GSEs, there was a Question as to whether a Privatized Ginnie Mae would Actually be able to Compete with Existing GSEs)

- The Senate approved a FY 2000 budget plan by a 55-44 vote on March 25 that would give the Appropriations Committee the option to use the privatization of Ginnie Mae and user fees as a way to pay for increases in education spending and other domestic programs. According to Congressional estimates, the sale of Ginnie Mae could raise \$2.5 billion. The Senate budget plan does not specifically mention the type of user fees, however, Fannie's Spokesperson John Buckley, noted it could be a reference to Ginnie Mae guarantee fees, and has nothing to do with Fannie or Freddie. "There is nothing that relates to Fannie and Freddie that is currently on either side of the aisle," Buckley stated.
- The FY 2000 budget plan approved by the House does not mention Ginnie Mae or user fees specifically, but it is also silent on how the appropriators can meet their spending targets similar to the Senate's, suggesting to Capitol Hill sources that the House may also be considering the privatization issue and user fees. "The House budget resolution does not specifically deal with the privatization of Ginnie Mae, nor do they specify user fees," stated Karen Kapen, Legislative Counsel for the Mortgage Bankers Association. "But, they have the same numbers and they have to raise the money somewhere."
- Fannie, Freddie, the Mortgage Bankers Association of America, the National Association of Home Builders, the National Association of Realtors sent a joint letter to Capitol Hill warning Senators that privatizing Ginnie Mae and raising user fees "would impair the ability of many of our citizens – especially first-time and minority homebuyers, veterans and rural residents – to finance the purchase of a home." The letter further stated that "We urge you to support greater homeownership opportunities by rejecting any attempts to assess homeownership taxes on low- and moderate-income American families to or privatize Ginnie Mae." As reported in previous *GSE*

Reports, earlier this year, the OMB considered, but decided not to include, the privatization of Ginnie Mae, the imposition of user fees on Fannie and Freddie and an increase the Ginnie Mae guaranty fee in the President's FY 2000 Budget.

- Mortgage industry officials, while not opposing privatization in principle, are reportedly concerned about the effect the plan would have on the ability of low-income borrowers to purchase a home. Any change in the full federal faith and guarantee of Ginnie Mae securities could affect Ginnie Mae's ability to reach borrowers in those underserved areas, according to the MBA. Sources on Wall Street and in the mortgage lending industry agreed that the big question in privatization centers on losing the guarantee of the full faith and credit of the United States government that stands behind the Ginnie Mae securities. A final vote in the House and Senate on a concurrent budget resolution is expected by the middle of April. (*National Mortgage News*, 3/22/99; *National Mortgage News website*, posted 3/26/99; *Real Estate Finance Today, Electronic Edition*, 3/26/99; *Mortgage-Backed Securities Letter-American Banker*, 3/29/99)

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