Two GSEs Cut Corners To Hit Goals, Report Says
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A House Financial Services Committee report shared with lawmakers Thursday accused Fannie Mae and Freddie Mac of engaging over several years in a series of dubious transactions to meet their affordable- housing goals. The nine-page report, a copy of which was obtained by American Banker, said the government-sponsored enterprises bought mortgage pools that contained commercial properties; bought pools with loans that were more than 20 years old; counted properties toward their goals that they never actually owned; and double-counted some mortgages.

"There is a legitimate question as to whether the GSEs violated the spirit of the housing goals," said the report, which was written by the committee's Republican staff. "If the purpose of the goals is to increase access to affordable housing, it is questionable whether the purchasing and securitizing of large pools of loans actually accomplishes this goal."

The new allegations are critical, as they could further undermine the positions of Fannie and Freddie ahead of a pending committee vote on a bill to create a new GSE regulator. And they came a day after Fannie Mae revealed it will stop using a popular accounting method for its investments after the company violated industry standards -- a move that could lower its book value as interest rates rise.

The report was written in the wake of the revelation last year that Fannie and Freddie, to meet housing goals, had counted large, yearend multifamily transactions in which the seller had an option to reverse them. The Department of Housing and Urban Development later said that without these reversible transactions, Fannie and Freddie would have missed their affordable-housing goals for 2003.

On April 27 of last year, House Financial Services Chairman Michael Oxley requested documents from Fannie and Freddie relating to the transactions. The report's authors said they had made their conclusions after reviewing "thousands of pages" of documents. Though it said the transactions did not "violate the letter of the law," the report highlighted several transactions that it said were inappropriate and did not promote affordable housing.

For example, the report said that Freddie entered into several transactions with General Motors Acceptance Corp. that involved the purchase of commercial properties, including a pool that contained a Wal-Mart; Sam's Club; Bed, Bath & Beyond; and a Winn-Dixie, among others. Only one-third of the pool contained residential mortgages, the report said.

The purchase of those commercial mortgage-backed securities "drives funds from Freddie Mac away from affordable-housing projects and helps supply liquidity to some of the largest corporations in the United States," the report said. It said that in 2002, Freddie entered into a transaction with Merrill Lynch, which required the GSE to provide a credit enhancement and liquidity support for a pool of tax-exempt bonds backed by a pool of multifamily mortgage loans held by Merrill. Freddie did not own the properties but used them nevertheless toward counting to its affordable-housing goals, the report said. Both GSEs, the report added, entered into transactions in which they bought pools of loans that included mortgages originated decades earlier. "Many of the mortgage pools contain properties that have been in repayment for 10 or 20 years," it said. "The securitization of loans 10 to 20 years after origination does not promote affordable housing in any substantial way."

The report cited several large transactions entered into by Fannie under which sellers were allowed to repurchase loans without recourse. For example, it said that in September 2003, Fannie bought the option to buy up to $12 billion of multifamily mortgage loans from Washington Mutual Inc. for a fee of $2 million, the report said. Under the agreement, the GSE permitted Wamu to repurchase the loans and granted the Seattle thrift company the status of a designated underwriter services.

"This was the largest multifamily transaction ever undertaken by Fannie Mae and was critical for Fannie Mae to reach the affordable- housing goals," the report said. It discussed a similar arrangement between Fannie and Bank of America Corp. in April 2003 through which Fannie bought a pool of 54,541 single-family mortgage loans valued at $10.5 billion. Under the agreement, B of A was allowed to dissolve the mortgage-backed securities "and have the loans returned to the lender or have new MBS issued."

The report said "one of the most troubling aspects of this review" was that the GSEs "double-count loans that have been securitized once, repurchased by a financial institution, and then resold to the GSE."

"This is in direct conflict with the spirit of the affordable- housing goals and amounts to nothing more than a shell game with the mortgage pools," the report said. "It is likely that financial institutions sold these mortgages to one of the GSEs, repurchased them, and then resold them to the second GSE."

A spokeswoman for Freddie Mac said that she had not read the report but noted its chairman and chief executive, Richard Syron, has said he does not want the company to rely on questionable transactions to meet its affordable-housing goals. A Fannie spokesman declined to comment for this story.

The report urged the Department of Housing and Urban Development to review these transactions to ensure that in the future these loans cannot be recounted, and said that the GSEs should develop systems to ensure that repurchases of the same loan or each other's loans are not taking place. In a final rule released last year setting new affordable-housing goals, HUD established a one-year blackout period on any reversible transaction and required Fannie and Freddie to make sure they were not double-counting their own, or each other's, mortgage purchases toward goals.

It was unclear what effect the new allegations will have on debate over the GSE bill. House Financial Services is widely expected to vote on the bill May 18 or May 25, and the Senate Banking Committee could act as soon as next month.

Fannie continues to reveal more accounting mistakes. In a filing with the Securities and Exchange Commission late Wednesday, it said that it must reclassify all its "held-to-maturity" securities as "available-for-sale" and stop using the held-to- maturity category for the next two years. The company had $453 billion of mortgage investments and $5.5 billion of nonmortgage investments in the held-to-maturity category as of June 30, 2004.

Classifying investments as held-to-maturity allowed Fannie to report the securities as an amortized cost on the balance sheet; if classified available-for-sale, they must be marked to fair value through shareholders' equity.

The company said it had to make the switch after an internal review found that the classifications were not done correctly under Financial Accounting Standard No. 115. Fannie said that the change would not affect its earnings or regulatory capital but that its accumulated other comprehensive income "will vary substantially from period to period as a result of this reclassification."