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*REPORT TO*
*THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS*
*UNITED STATES SENATE*

# Information On The Secondary Mortgage Market Activities Of The Federal National Mortgage Association And The Federal Home Loan Mortgage Corporation

Federal National Mortgage Association
Federal Home Loan Mortgage Corporation

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*BY THE COMPTROLLER GENERAL*
*OF THE UNITED STATES*

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MAY 6, 1975

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-114828

The Honorable William Proxmire
Chairman, Committee on Banking,
Housing, and Urban Affairs
United States Senate

Dear Mr. Chairman:

By letter of July 26, 1974, Senator John Sparkman, then Chairman of the Senate Committee on Banking, Housing, and Urban Affairs, and Senator John Tower, Ranking Minority Member, asked GAO to study the role Government agencies play in the secondary market for mortgages. As subsequently agreed with Senator Sparkman's office, we are providing information on the 10 areas listed below as they relate to the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association, the principal Government agencies operating in the secondary market for mortgages.

--Legislative history of the Federal Association and the Corporation after 1968.

--Criteria used by the Federal Association and the Corporation to insure the quality of conventional mortgages they buy.

--Criteria used by the Federal Association to buy Government-backed mortgages.

--Comparison of the mortgage-buying practices of the Federal Association and the Corporation.

--Comparison of the mortgage-selling practices of the Federal Association and the Corporation.

--Past and future plans of the Federal Association and the Corporation to sell mortgages they have bought.

--Types of investors who buy the Federal Association and the Corporation debentures.

--General data on the services provided by the Federal Association to the Government National Mortgage Association.

--Evaluation of the potential impact of H.R. 11221, 93d Congress, 2d session, on the Corporation's operations. This bill was enacted into law in a substantially different form.

--Groups that are studying the secondary market for mortgages.

Our review at the Washington headquarters of the Federal Association, the Corporation, the Government National Mortgage Association, the Mortgage Bankers Association of America, and the U.S. Savings and Loan League included discussions with officials of these organizations and an examination of documents which they made available to us. Each of the 10 areas are briefly discussed below and more details are presented in the appendix.

Although legislation has formed the Federal Association and the Corporation into organizations with similar authority relating to buying and selling mortgages, they serve primarily different markets. The Federal Association generally buys and sells Government-backed mortgages from mortgage bankers; however, since 1972, it has been steadily increasing its purchases of conventional mortgages. On the other hand, the Corporation generally buys and sells conventional mortgages from savings and loan associations. An important difference between the Federal Association and the Corporation is that the Corporation cannot sell to or buy from certain classes of mortgage originators with whom the Federal Association can deal; for example, mortgage bankers.

The Federal Association and the Corporation are both required by law to confine their conventional mortgage purchases to mortgages which are of such quality, type, and class as to generally meet the purchase standards imposed by private institutional mortgage investors. The Federal Association provides assurance that the above criteria are met through a two-level process in which it examines and approves each seller and each conventional mortgage it buys. The Corporation does not individually approve most of the organizations it deals with but it does examine and approve each conventional mortgage it buys. Both the Federal Association and the Corporation apply generally the same credit and property criteria in buying conventional mortgages. (See p. 8.)

Since January 1969 the Federal Association has automatically accepted Government-backed mortgages with no additional examination. (See p. 14.)

The Federal Association and the Corporation buy mortgages differently. The Federal Association's mortgages are usually subject to previously obtained commitment contracts. The price the Federal Association pays for mortgages is determined in an auction or is set by the Federal Association partly on the basis of auction results. The Corporation usually buys mortgages through an over-the-counter process, subject to a purchase contract at a price which it administratively determines. (See p. 15.)

The Federal Association and the Corporation also sell mortgages differently. The Federal Association sells mortgages outright to investors. The Corporation sells mortgages through participation sale certificates which are undivided interests in mortgage pools which it guarantees and manages. (See p. 27.)

Due to a lack of supply of mortgage credit, both the Federal Association and the Corporation have sold a much smaller volume of mortgages than they have bought. The Federal Association believes that it can and will continue to buy more mortgages than it sells, as long as market conditions require it to supplement the market primarily as a buyer. The Corporation, on the other hand, intends to increase its sales to more closely balance its buying and selling volume. (See p. 29.)

The Federal Association finances its operations primarily through the sale of debentures. Commercial banks purchase about 63 percent of the debentures; savings and loan associations buy about 10 percent of the debentures and are the second largest class of buyers. The Corporation finances its operations by borrowing from the Federal Home Loan Bank System and by issuing the Government Association-guaranteed mortgage-backed bonds. (See p. 32.)

The Federal Association carries out the day-to-day activities relating to the Government Association's special assistance, conventional mortgage purchase, mortgage-backed security, and management and liquidation programs. The Government Association reimbursed the Federal Association $6,085,302 for these services in fiscal year 1974 and $1,147,555 during the first 3 months of fiscal year 1975. (See p. 34.)

Public Law 93-495 (12 U.S.C. 1454), which was derived from H.R. 11221, was enacted into law on October 28, 1974, and is substantially different from the original version of the bill. The new law increases the Corporation's authority by authorizing it to buy residential mortgages from financial institutions which have deposits or accounts insured under State laws and which have more than 20 percent of the total time and savings deposits of all such institutions in that State. The institutions falling into the above category are almost exclusively mutual savings banks; the Massachusetts mutual savings banks and cooperative banks are the only State financial institutions presently eligible under this act.

According to a Corporation official, permitting State-insured institutions in Massachusetts to sell to the Corporation will not have an immediate impact on or greatly change its operation. (See p. 37.)

We could not identify any secondary mortgage market studies which Government or non-Government organizations are doing or have recently done. The Department of the Treasury is considering initiating a study about the impact of Federal credit programs on economic and financial institutions. A Treasury official told us that no work has been done on the study but that the target date for completing the study is December 1975.

As requested by Senator Sparkman's office, we have not provided the Federal Association or the Corporation officials with the opportunity to comment on this report. However, we have discussed our observations with them and have considered their views in finalizing this report.

Copies of this report are being sent to Senator Sparkman and Senator Tower.

We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

## C o n t e n t s



## ABBREVIATIONS

| | |
|---|---|
| FNMA | Federal National Mortgage Association |
| FHLMC | Federal Home Loan Mortgage Corporation |
| GNMA | Government National Mortgage Association |
| FHA | Federal Housing Administration |
| VA | Veterans Administration |

## BACKGROUND

The housing industry often has a shortage of funds for financing mortgages. To help the housing industry provide mortgage financing when funds are scarce, the Congress created the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC). In general, FNMA and FHLMC buy mortgages when mortgage funds are in short supply and sell mortgages when there is an oversupply of funds. The secondary mortgage market activities of FNMA and FHLMC are discussed in the following sections.

# LEGISLATIVE HISTORY AND MISSION OF FNMA AND FHLMC

## FNMA

### History

FNMA was created in 1938 as a wholly owned Government corporation pursuant to title III of the National Housing Act of 1934 (12 U.S.C. 1717) to provide assistance to the mortgage market by purchasing from lending institutions home mortgages insured by the Federal Housing Administration (FHA). The Housing Act of 1954 (12 U.S.C. 1716, et. seq.) converted FNMA into a mixed-ownership corporation. As such, FNMA's preferred stock was held by the Federal Government (Secretary of the Treasury), and its common stock was privately held. This act authorized FNMA to

--provide supplementary assistance to the secondary market for home mortgages by providing a degree of liquidity for mortgage investments, thereby improving the distribution of investment capital available for home mortgage financing;

--provide special assistance (when, and to the extent that, the President has determined that it is in the public interest) for the financing (1) selected types of home mortgages (pending the establishment of their marketability) originating under special housing programs designed to provide housing of acceptable standards at full economic costs for segments of the national population which are unable to obtain adequate housing under established home financing programs, and (2) home mortgages generally as a means of retarding or stopping a decline in mortgage lending and home building activities which threatens materially the stability of a high-level national economy; and

--manage and liquidate the existing mortgage portfolio in an orderly manner, with a minimum of adverse effect on the home mortgage market and minimum loss to the Federal Government.

The Housing and Urban Development Act of 1968 (12 U.S.C. 1717) partitioned FNMA into two separate corporations, effective September 1, 1968. A new FNMA was established as a Government-sponsored private corporation to conduct secondary market operations. The second corporation, the Government National Mortgage Association (GNMA), was established as a Government-owned corporation to conduct the original FNMA's special assistance, management, and liquidating functions and to act as trustee for a number of financing trusts for which the original FNMA had been trustee. The trusts had been created under authority of the Housing Act of 1964 and the Participation Sales Act of 1966 (12 U.S.C. 1717).

The 1968 act provided for FNMA's stockholders to acquire control of its board of directors after May 1, 1970, and before May 1, 1973, if at least one-third of FNMA's common stock was owned by persons or institutions in the mortgage lending, homebuilding, real estate, or related businesses. This condition was met in February 1970, and FNMA completed its transition to private control in May 1970.

Mortgage purchase authority

The types of mortgages which FNMA may purchase and sell and the legislative authority authorizing such transaction are as follows.

--FHA-insured mortgages (Public Law 424, 12 U.S.C. 1717(b), Feb. 3, 1938).

--Veterans Administration (VA)-guaranteed mortgages (Public Law 864, 12 U.S.C. 1717(b)(1), July 1, 1948).

--Mortgages made by the Department of Health, Education, and Welfare for construction or modernization of publicly owned hospitals (Public Law 91-296, 42 U.S.C. 291j-7(b), June 30, 1970).

--Conventional mortgages (Public Law 91-351, 12 U.S.C. 1717b, July 24, 1970).

The Housing and Community Development Act of 1974 (Public Law 93-383, 88 Stat. 633 et seq.) enacted August 22, 1974, increased (1) the maximum principal amount of a single-family mortgage which FNMA may purchase from $33,000 to $45,000 for FHA and VA mortgages and from $35,000 to $55,000 for conventional mortgages[1] and (2) the maximum conventional loan which FNMA may purchase from 75 to 80 percent of the mortgaged property's value unless the mortgage is covered by insurance, a replacement agreement, or a participation agreement. The act also increased from 10 to 20 percent the proportion of loans over 1 year old which FNMA may purchase.

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[1] Conventional mortgages on properties in Alaska, Guam, and Hawaii may exceed the $55,000 limit by up to 50 percent.

## Changes in FNMA's capital structure and financing authority

As part of its reformation into a private corporation, various laws changed FNMA's capital and financial structure as follows:

--The Housing and Urban Development Act of 1968 (1) changed FNMA common stock from nonvoting and $100 par value to voting and no par value, (2) repealed a provision allowing retirement of the common stock at par value, (3) revoked FNMA's authority to issue preferred stock, (4) authorized FNMA to sell common stock to the general public, and (5) required servicers of FNMA-held mortgages to own a specified amount of FNMA stock.

--The Housing and Urban Development Act of 1968 (1) gave FNMA authority to issue obligations secured by mortgages and made such obligations exempt securities within the meaning of laws administered by the Securities and Exchange Commission, (2) authorized FNMA to issue, within specified limits, subordinate obligations and obligations convertible into common stock, and made all such obligations exempt securities within the meaning of laws administered by the Securities and Exchange Commission, (3) repealed a provision prohibiting FNMA from borrowing from the Treasury after retirement of its preferred stock, and (4) gave FNMA the authority to purchase GNMA-guaranteed securities.

--The Housing and Community Development Act of 1974 repealed provisions relating to preferred stock which FNMA retired and can no longer issue.

## Tax structure

The 1968 Housing Act established FNMA as a private corporation subject to Federal corporate income tax but exempt from State, county, and local taxes, with the exception of taxes on real property. The act also repealed a provision under which the original FNMA annually paid a Federal income tax equivalent to its secondary mortgage market operations.

## Federal regulation of FNMA

Although privately owned, FNMA is subject to certain Federal supervision and regulation, as follows.

--The Housing Act of 1968 gave the Secretary of Housing and Urban Development the authority to (1) limit the amount of debt which FNMA can have outstanding at any one time, (2) limit the amount of cash which FNMA can pay as a dividend on each share of common stock, (3) exercise general regulatory powers over FNMA operations, including the right to require that a reasonable portion of FNMA's mortgage purchases be related to the national goal of providing adequate housing for low- and moderate-income families, and (4) examine and audit FNMA books and financial transactions.

--The Housing Act of 1968 (12 U.S.C. 1723(b)) gave the President of the United States authority to appoint 5 of the 15 members on FNMA's Board of Directors.

--The Housing and Urban Development Act of 1970 (12 U.S.C. 1718(c), Dec. 31, 1970) gave the Secretary of Housing and Urban Development the authority to approve the stock purchase requirements which FNMA imposes on its sellers.

## Mission

FNMA attempts to carry out the Congress intent that FNMA "provide supplementary assistance" by buying and selling mortgages in such a manner that it does not preempt the market as a buyer or seller. The buying programs are intended to supply funds when they are not available from traditional sources at a better yield, and the selling programs are intended to supply mortgages to investors when the primary mortgage market has an excess supply of funds for investment.

## FHLMC

## History

Before 1970 FNMA served as the secondary market for federally insured FHA and VA mortgages. There was no secondary market facility for nonfederally insured (conventional) residential mortgages. The principal source of capital for this segment of the market was thrift institutions (savings and loan associations and mutual savings banks). When thrift institutions experienced money shortages, they would stop lending money for mortgages. The Congress recognized this problem and in July 1970 created the FHLMC under title III of the Emergency Home Finance Act of 1970 (12 U.S.C. 1452 et. seq.) to strengthen and further develop the secondary market primarily in conventional mortgages and to thereby increase housing availability. FHLMC buys and sells conventional and FHA and VA mortgages and uses innovative ideas to make mortgages more marketable.

The act authorized FHLMC to issue nonvoting common stock to the Federal home loan banks. The stock, 100,000 shares at a par value of $1,000 per share, was distrubuted to the 12 Federal home loan banks depending on their size and activities. FHLMC is exempt from Federal, State, county, and local income tax, with the exception of taxes on real property. The Chairman of the Federal Home Loan Bank Board, at the time FHLMC was established, felt that FHLMC's earnings should be exempt from Federal income tax. He said since FHLMC was to be administered with capital contributed by tax-exempt entities (the Federal Home Loan Bank Board and the Federal home loan banks) and since the major objective of FHLMC's secondary market activity is not profit, the earnings should not be taxed but retained for growth of the equity base of $100 million.

FHLMC's Board of Directors is composed of the members of the Federal Home Loan Bank Board who serve in a dual capacity without additional compensation. FHLMC also has an advisory committee composed of 12 members selected by the 12 Federal home loan banks and 4 public interest members selected by the Federal Home Loan Bank Board.

Subsequent changes to the act were made by Public Laws 93-383 and 93-495 (12 U.S.C. 1454). Public Law 93-383, the Housing and Community Development Act of 1974, allows mortgages bought by FHLMC to be serviced by HUD-approved mortgagees, which include mortgage bankers. It also increased the maximum loan-to-value ratio from 75 to 80 percent of the mortgaged property's value which is not covered by mortgage insurance, a replacement agreement, or a participation agreement. Further, it increased the limits for buying mortgages more than 1 year old from 10 to 20 percent of the total mortgages bought. Public Law 93-495 increased FHLMC's authority by authorizing it to buy mortgages from financial institutions which have deposits or accounts insured under State laws and which have more than 20 percent of the total time and savings deposits of all such institutions in that State. (See p. 37.)

## Mission

FHLMC's mission is to increase the availability of mortgage credit for financing urgently needed housing. FHLMC officials believe this mission is to be accomplished by creating a viable secondary market for conventional residential mortgages. To do this, FHLMC has undertaken the development of the necessary tools, methods, and markets required to allow mortgages to compete for capital on an equal basis with other investment instruments in the capital market. Some of FHLMC's efforts along these lines include: uniform mortgage documents, a computerized underwriting matrix, mortgage-backed securities, a futures market for mortgages, and an automated mortgage market information network for communicating mortgage market offers among buyers and sellers.

According to FHLMC officials, FHLMC has strived to establish a "true" secondary market (a market in which mortgages are sold as well as bought), which would increase the availability of mortgage credit.

## PROCEDURES TO INSURE THE QUALITY OF THE CONVENTIONAL MORTGAGES BOUGHT BY FNMA AND FHLMC

### FNMA

FNMA uses a two-level screening procedure to insure that it purchases only quality mortgages which would be acceptable to private institutional investors. On the first level, FNMA reviews the qualifications of both the organizations wishing to sell and the organizations' professionals that will prepare the documentation that FNMA requires.

FNMA requires that a seller must at all times be an organized business enterprise which has as one of its principal purposes the making or purchasing of conventional real estate mortgages. Such mortgages must be made "in the regular, usual, and normal course of business." In addition, the seller must maintain a net worth of not less than $100,000 in assets acceptable to FNMA and must submit a copy of its latest yearend financial statement to FNMA.

The appraisers, underwriters, and attorneys that the seller uses must meet certain education and experience qualifications and must demonstrate a record of acceptable professional performance and technical ability to FNMA.

On the second level FNMA's underwriting staffs in its 5 regional offices review the package of documents submitted with each mortgage to insure that FNMA's requirements relating to required documents, contract conditions, quality of property, and the borrower's ability to repay the loan are met.

A recent FNMA study pointed out that an incomplete mortgage package is one of the major reasons why FNMA rejects mortgages submitted for purchase. From January through September 1973, 27.1 percent of conventional mortgage rejections were for this reason. In the same 9-month period of 1974, incomplete mortgage packages accounted for 16.7 percent of the rejections.

The conditions of the mortgage contract must conform to the following FNMA requirements.

--The original term of the mortgage may not exceed 30 years from the date of commencement of amortization of principal, and the term of the mortgage at the time of delivery to FNMA may not be less than 10 years.

--The unpaid principal balance of the mortgage at the time of purchase by FNMA may not exceed 80 percent of the value of the security property, with the following exceptions:

(1) The unpaid principal balance may exceed 80 percent but may not exceed 95 percent (90 percent for condominium units) of the value of the security if the excess is insured by a mortgage insurer acceptable to FNMA.

(2) The unpaid principal balance may exceed 80 percent but may not exceed 90 percent of the value of the security if the seller offers an acceptable agreement to repurchase the mortgage in the event of default before the unpaid principal balance is reduced to 80 percent of the value of the security.

(3) FNMA will consider purchasing part of a mortgage on a negotiated basis.

FNMA's guidelines for determining the quality of a mortgaged property deal with location (for example, the type of road providing access to the property and the amount of industry in the area), and the characteristics of the property (for example, the square footage of living area and electrical and plumbing facilities). The underwriting personnel determine quality on the basis of their judgment and expertise.

For the first 9 months of 1974, FNMA rejected 19.1 percent of the conventional mortgages submitted to it because the properties were not of an acceptable quality.

FNMA's guidelines for use by lenders in awarding mortgages were designed to insure FNMA's acceptance of the mortgages in case the lenders want to sell them to FNMA.

FNMA's guidelines on loan repayment deal with the borrower's credit rating, current financial situation, and income stability. FNMA requires the seller to obtain a credit rating on the borrower.

FNMA's guidelines on the borrower's current financial situation set acceptable limits for the amount of total monthly mortgage payment, and total monthly mortgage payment plus any other monthly installment obligations which extend beyond 10 months. These limits are set at 25 and 33 percent, respectively, of allowable gross income. Also, the guidelines require that documentation clearly establish that the borrower had sufficient liquid funds for the required downpayment and that the sources of the funds were clearly established.

To judge the stability of the borrower's earnings, FNMA's guidelines concern length of continuing employment; sources of income, and, in the case of joint title to the property, a determination of the amount of combined income which can be expected to pay off the mortgage.

When it initiated its conventional mortgage purchase program in 1972, FNMA rejected about 40 percent of the mortgages submitted because sellers failed to comply with FNMA's guidelines. Mortgages were rejected primarily because of incomplete documentation and the unacceptability of the securing property. An FNMA official said that FNMA held a series of nationwide seminars early in 1973 to acquaint sellers with FNMA's guidelines for submitting mortgages. After the seminars the mortgage rejection rate had dropped to 18.4 percent in 1974.

At September 30, 1974, the results of FNMA's conventional underwriting process were:

| | |
|---|---|
| Conventional mortgages: | |
| Total purchased | 73,376 |
| Total forclosed | 59 |
| In process of foreclosure | 72 |
| Delinquency rate (payments more than 2 months past due) | 0.7 percent |

The effectiveness of FNMA's underwriting program is seen in the comparison of FNMA's delinquency rate with the rate for other lenders. The 2-month past-due delinquency rate for conventional mortgages initiated by mortgage bankers at September 30, 1974, was 0.65 percent. The 2-month delinquency rate for all types of mortgages initiated by savings and loan associations at this time was 0.84 percent. The U.S. Savings and Loan League did not have a delinquency rate for conventional loans only.

## FHLMC

Section 305 of the Emergency Home Finance Act of 1970 requires that mortgages purchased by FHLMC meet the purchase standards normally imposed by private institutional investors. To insure the quality of mortgages it purchases, FHLMC reviews sellers' mortgage loan information for necessary documents and compliance with FHLMC's mortgage eligibility requirements; the stability and marketability of the property secured; and the adequacy of the borrower's credit.

Data from the loan documents is keypunched into a computer which compiles and processes the information.[1] The computer program (underwriting matrix) is designed to test compliance with FHLMC's requirements, the characteristics of the property secured, and the borrower's credit.

FHLMC checks the mortgage loan eligibility criteria to determine whether the conditions of FHLMC's enabling act are met. The loan criteria are as follows:

--The loan-to-value ratio of one-unit dwellings cannot exceed 80 percent of the purchase price or appraised price, whichever is less, unless the loan has mortgage insurance. The loan-to-value ratio, however, cannot exceed 95 percent with mortgage insurance.

--The loan-to-value ratio of two-, three-, and four-unit dwellings is limited to 80 percent of the purchase price or appraised price, whichever is lower.

--The maximum original term of a home mortgage is 30 years, and the minimum loan term is 10 years.

--The cash downpayment, plus trade or other equity, must be at least equal to 5 percent or more of the appraised value or purchase price, whichever is lower.

--The single-family residence must be owner-occupied at the time FHLMC buys the mortgage.

--Each mortgage must provide for regular monthly payments. Loans with large lump-sum payments at the end of the loan term are ineligible for purchase.

--Each home mortgage must be closed in the seller's name or validly assigned and endorsed to the seller.

--The mortgaged premises must be geographically located within the State of the seller's principal office or within 100 miles of its office, or within 100 miles of each out-of-State branch office or subsidiary of the seller, provided that FHLMC has approved the subsidiary office as a servicing facility in writing.

FHLMC's evaluation of the secured property is based on selected site visits and an appraisal report submitted by

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[1]Since multifamily mortgages only account for about 700 of FHLMC's 226,792 total purchases, we are limiting our discussion to single-family mortgages.

the seller. The appraisal report establishes property value and contains an analysis of the property with respect to the neighborhood, site, and improvements to the property. The FHLMC appraisal form is designed so that most of the property features are rated either poor, fair, average, or good by the seller's appraiser. Besides reviewing documents furnished by the seller, FHLMC will also make test appraisals and other checks in order to insure proper underwriting.

The information on the residential loan application and the credit report normally provide enough documentation to determine the borrower's ability to repay the loan. FHLMC considers information relating to the borrower's job, employment tenure and opportunities for the future, age, educational background, and training. The borrower's financial strength must be sufficient to carry the mortgage loan payments of principal, interest, taxes, insurance, and other normal credit obligations that the borrower may be expected to incur. The following guidelines are generally applied in reviewing a borrower's credit.

--The monthly housing expenses (mortgage payment, taxes, insurance, and other expenses required to be paid under the mortgage) should not exceed 25 percent of the borrower's stable gross monthly income.

--The total amount of monthly housing expenses, plus all other monthly payments on all installment debts having remaining terms of more than 7 months, should not exceed 33-1/3 percent of the borrower's stable gross monthly income.

--If the borrower has a recent history of slow payments on a previous mortgage, the seller must furnish a detailed written explanation as to why the borrower has established a slow payment record.

--If the borrower has been bankrupt, the seller must submit evidence that the borrower is considered an adequate risk.

--If the borrower has changed occupations three or more times within the past 5 years or if he has changed residences four or more times within the past 6 years, the seller must submit information which explains the reasons for these changes.

When FHLMC first began buying conventional mortgages, the rejection rate was about 30 percent. These mortgages were rejected because the sellers submitted inadequate documentation or questionable appraisal reports or failed to comply with FHLMC regulations. FHLMC officials told us that there were fewer rejections after the sellers became familiar with FHLMC's programs and requirements. The rejection rate for single-family mortgages purchased by FHLMC is low, presently about 8 to 10 percent.

At September 30, 1974, the results of FHLMC's conventional underwriting process were:

| | |
|---|---|
| Conventional mortgages: | |
| Total purchased | 114,476 |
| Total foreclosed | 88 |
| In process of foreclosure | 93 |
| Delinquency rate (payments more than 2 months past due) | 1.7 percent |

## FNMA CRITERIA FOR PURCHASING GOVERNMENT-BACKED MORTGAGES

Since January 1969, FNMA has been purchasing FHA and VA mortgages without doing its own underwriting of those mortgages. According to FNMA officials FNMA relies on FHA and VA underwriting for the following reasons:

--FNMA would incur an increased cost which it would have to pass on to homebuyers if it underwrote mortgages previously underwritten by FHA and VA.

--FNMA does not receive enough information from FHA and VA to reunderwrite mortgages.

--FNMA feels FHA and VA, because of their many field locations, are in a more knowledgeable position to underwrite mortgages than FNMA.

--FNMA's loss on FHA and VA mortgages, which amounted to $5,893,000 in 1974, has been at an acceptable level.

--FNMA's underwriting would be duplicating FHA's and VA's underwriting.

## PURCHASE PROGRAMS OF FNMA AND FHLMC

FNMA and FHLMC purchase programs are different. FNMA primarily buys mortgages subject to previously obtained commitment contracts. The price it pays for mortgages is determined in an auction or is set by FNMA partly on the basis of auction results. FHLMC primarily buys mortgages through an over-the-counter process, without a prior commitment, at a price which it administratively determines. Below is information on each agency's purchase program.

### FNMA

FNMA buys FHA, VA, and conventional mortgages on one- to four-unit family homes, FHA-insured mortgages on projects,[1] and conventional mortgages on single units in condominiums and planned-unit developments.[2] At the end of 1973 about 2,800 organizations were eligible to sell mortgages to FNMA. The types of organizations and the amount of mortgages purchased from these organizations during the 12-month period ended September 30, 1974, are shown on the following page.

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[1]Projects include apartment houses, mobile home parks, nursing homes, hospitals, and group medical practice facilities.

[2]A planned-unit development consists of separately owned lots with contiguous or noncontiguous areas or facilities usually owned by an association in which the owners of the lots have a stock or membership interest. Title to the real estate under the dwelling units is held by the lot owners, not by the association. The association usually has title to and administers the common areas.

SUMMARY OF TOTAL FNMA MORTGAGE PURCHASES
BY INSTITUTION TYPE
September 30, 1973, to September 30, 1974

| Type of institution | Number of mortgages | Principal purchased (000 omitted) | Percent of principal |
|---|---|---|---|
| Single-family mortgages: | | | |
| Mortgage companies | 198,542 | $4,670,304 | 90.7 |
| Federal savings and loan | 656 | 18,198 | .4 |
| State savings and loan | 1,430 | 32,700 | .6 |
| Insurance companies | 687 | 15,634 | .3 |
| National banks | 6,897 | 170,758 | 3.3 |
| State banks | 3,643 | 91,983 | 1.8 |
| Other institutions | 7,336 | 148,490 | 2.9 |
| Total | 219,191 | $5,148,067 | 100.0 |
| Project mortgages: | | | |
| Mortgage companies | 878 | $1,430,228 | 63.2 |
| Federal savings and loan | 29 | 50,753 | 2.3 |
| State savings and loan | 21 | 40,148 | 1.8 |
| Insurance companies | 2 | 1,336 | .1 |
| National banks | 205 | 398,963 | 17.6 |
| State banks | 115 | 256,291 | 11.3 |
| Other institutions | 50 | 83,553 | 3.7 |
| Total | 1,300 | $2,261,272 | 100.0 |
| Total | 220,491 | $7,409,339 | |

Mortgages are serviced throughout their lives. Services involve collecting mortgage payments; following up on delinquencies; handling taxes, insurance matters, and foreclosures; and submitting reports to mortgage holders. FNMA services the project mortgages it holds and the sellers or contract parties service the single-family mortgages in FNMA's portfolio. For servicing purposes, single units in condominiums and planned-unit developments are treated like single-family homes.

## Single-family home program

FNMA first bought single-family home mortgages through an over-the-counter process. The mortgages were bought at a stated price for immediate delivery. The posted prices varied by geographical areas and were determined on the basis of frequent surveys of local mortgage yields. FNMA discontinued its over-the-counter purchase program because:

--It was difficult to keep up with all the price fluctuations that constantly took place in the market.

--The system tended to discriminate among local mortgage market areas. It was difficult to make realistic distinctions as to mortgage prices in many areas. Discrimination among geographical areas could result from this lack of price distinction or from the fact that the system failed to provide a good method for making a fair allocation of the limited purchase funds available.

--The over-the-counter system failed to give members of the home-building and mortgage-lending industries the assurance they needed to plan ahead.

In 1968 FNMA initiated a program which requires sellers to bid against each other in auctions to obtain fund commitments for various lengths of time. The seller's bid is the minimum yield at which he will sell mortgages to FNMA. The combination of mortgage interest rate and price determine the yield. Only 4-month commitments are currently available through the auction. FNMA determines the volume of commitments it will accept at each auction on the basis of the amount of bids received, the yields offered, and its projection of future capital and mortgage market conditions. FNMA also determines the lowest yield it will accept at the auction and accepts all higher bids. Separate but simultaneous auctions are held every other Monday for FHA, VA, and conventional mortgages. FNMA limits the maximum size of a bid so that no one bidder will dominate the auction. The maximum amount of a bid accepted by FNMA during our review was $3 million on FHA, VA, and conventional mortgages.

FNMA also accepts noncompetitive bids for commitments from sellers who do not want to risk having their bids rejected. Their bids are automatically accepted at the average yield of all accepted competitive offers. The maximum size of noncompetitive bids which FNMA will accept is $200,000 for FHA and VA mortgages and $100,000 for conventional mortgages.

Because FNMA commitments are subject to optional delivery contracts, the seller has the choice of delivering all or part of the mortgages to FNMA for purchase. A seller may choose not to deliver his mortgages to FNMA under his commitment contract if he finds better financing elsewhere because there is no penalty if he fails to deliver.

A seller is required to incur certain expenses in obtaining 4-month commitments through FNMA's auction. To enter a competitive offer in an auction, the seller must pay a nonrefundable fee of one-hundredth of 1 percent of the amount of his offer (no offer fee is required on noncompetitive offers). Also, a nonrefundable commitment fee of one-half of 1 percent of the dollar amount of accepted offers is required. For mortgages delivered, the seller must subscribe for FNMA common stock in an amount equal to one-fourth of 1 percent of the unpaid principal balance of the mortgages.

FNMA believes the commitment auction, which it calls the free market system, has the following advantages over the stated-price system.

--Provides FNMA greater assurance that, when it accepts bids in the high ranges of those submitted, it is achieving a yield on its investment which reflects current market conditions more accurately than was possible under the fixed-price system.

--Provides a marketing mechanism for allocating available purchase funds among local market areas according to their needs.

--Enables mortgage sellers, homebuilders, and real estate companies to plan their future activities since they know that FNMA funds will be available if they cannot obtain better financing elsewhere.

The following table shows the extent to which 4-month commitments are actually used.

Free Market System Auction Commitments

| Year | Issued by FNMA | | Used by seller | | Percent used | |
|---|---|---|---|---|---|---|
| | FHA and VA mortgages | Conventional mortgages | FHA and VA mortgages | Conventional mortgages | FHA and VA mortgages | Conventional mortgages |
| | (millions) | | | | | |
| 1970 | $5,052 | (a) | $4,778 | (a) | 95 | (a) |
| 1971 | 3,499 | (a) | 1,730 | (a) | 49 | (a) |
| 1972 | 2,921 | 319 | 1,643 | 55 | 56 | 17 |
| 1973 | 3,068 | 1,300 | 2,524 | 789 | 82 | 61 |
| 1974 (note b) | 2,175 | 561 | 1,564 | 380 | 72 | 68 |

[a]Not applicable.

[b]First 9 months of 1974.

On October 24, 1972, FNMA began issuing Convertible Standby Commitments--12-month commitments with a conversion option--for FHA and VA mortgages relating to one- to four-unit family homes. On January 30, 1973, FNMA began issuing conventional mortgages relating to single-family residences. These commitments are for delivery at the seller's option and provide the seller with a fixed price for the committed funds over the 12 months. FNMA periodically determines the yield at which such commitments will be offered on the basis of yields obtained in the free market system auction with a yield factor added because of the additional interest rate risk associated with a 12-month commitment.

If the market should improve during the 12-month commitment period, the seller may, for a fee, convert the commitment to a 4-month commitment at a yield equal to the average yield in the auction for 4-month commitments immediately preceding the date of conversion. Upon conversion, the remaining commitment period is reduced to 4 months, but in no case can it exceed the expiration date of the original commitment.

The seller who obtains a Convertible Standby Commitment must pay a processing fee of one-hundredth of 1 percent of the requested commitment and a commitment fee of 1 percent (one-half payable when the commitment is made and the remaining half when the commitment is used). He must subscribe for FNMA common stock in an amount equal to one-fourth of 1 percent of the unpaid principal balance of any mortgages delivered under the commitment.

FNMA made the following commitments under each program in 1973 and 1974.

| Program | Commitment volume 1973 | 1974 (through Oct. 21, 1974) |
|---|---|---|
| | (millions) | |
| 4-month auctions: | | |
| FHA and VA mortgages | $3,068.4 | $2,231.5 |
| Conventional mortgages | 1,300.1 | 596.5 |
| 12-month stated yield: | | |
| FHA and VA mortgages | 725.1 | 1,932.0 |
| Conventional mortgages | 1,031.7 | 386.3 |

FHA-insured project mortgages

FNMA purchases FHA project mortgages on apartment houses, mobile home parks, nursing homes, hospitals, and group medical facilities, subject to Standby Project Commitments or Immediate Purchase Contracts. A seller may obtain a Standby Project Commitment, which is an optional delivery contract, for a period of up to 2 years. FNMA determines the commitment yield on the basis of (1) current yields at the time the commitment is made and (2) the inherent risk involved in making a commitment at a specified yield for a term of up to 2 years. FNMA has not included project mortgages in its auction system because:

--The commitment period needed by the builder and lender is relatively long.

--The projects are large and complex, requiring commitments to be individually prepared and their timing coordinated with FHA mortgage insurance commitments.

--Project mortgages involve a greater variety of legal instruments and issues than are involved in mortgages on completed individual homes.

Sellers may obtain an Immediate Purchase Contract from FNMA by which a mortgage can be delivered without a prior commitment if FHA's final insurance endorsement has been received and the project is generating income to pay all expenses, including the mortgage debt. The yield in the free market system auction is an important factor which FNMA considers in establishing the required yield on these contracts.

According to FNMA officials, both of FNMA's project programs are seldom used presently because (1) builders can obtain better financing through Government-sponsored programs administered by GNMA, (2) there are problems relating to FHA processing, and (3) owners are unable to obtain rent levels high enough to make projects feasible.

The volume of 2-year commitments issued during the first 9 months of 1974 was $2.2 million. The volume of immediate purchases during 1974 was $1,310,703.

Single units in condominiums and planned-unit developments

In 1974 FNMA established a program to provide a national secondary market for conventional mortgages on individual units in condominiums and planned-unit developments. (See footnote on p. 15.) Under this program, FNMA may approve an entire condominium or planned-unit development. Once approved, any lender which FNMA has previously approved may secure a commitment of funds. More than one FNMA-approved lender may obtain a commitment and deliver mortgages in a single project.

FNMA expects that, besides committing its own resources to this program, its certificate of approval will enhance the attractiveness of these projects to other investors without repeating the complex legal examination of project documentation.

Through September 1974 FNMA had approved two condominium developments.

GNMA tandem plans and actions

On December 23, 1974, FNMA terminated a program under which it bought mortgages from GNMA. FNMA bought these mortgages in accordance with "tandem" plans, which were special agreements between FNMA and GNMA. Under these plans GNMA entered into commitments to buy mortgages at less-than-market yields, expecting to sell them later to FNMA or other investors at market yields. GNMA absorbed any loss on such sales.

GNMA made the commitment to buy mortgages from the original lenders in association, or "tandem," with a separate agreement between GNMA and FNMA by which the commitment was assigned to FNMA. FNMA thereby agreed (subject to certain limitations as to aggregate purchase amounts) to buy the mortgages if called upon, but GNMA was free to buy the mortgages or arrange to sell the mortgages to another investor if it could obtain a higher price. FNMA received a fee to compensate for the work and risk involved in carrying the commitment.

At the time these arrangements were entered into, it was uncertain whether some of the mortgages involved would eventually be purchased from the originating lender by FNMA or by some other investor or whether GNMA would buy the mortgages. Under "buy-back" arrangements entered into between the original lender and GNMA, the original lender may sell the mortgage to GNMA, then buy it back and become the permanent holder.

GNMA periodically holds auctions to sell mortgages purchased under its various programs. FNMA, one of many bidders, has bought only a minor share of GNMA's mortgages.

## FHLMC

FHLMC buys most of its conventional, FHA, and VA mortgages from members of the Federal Home Loan Bank System, and other federally insured financial institutions that FHLMC has approved. Members of the Federal Home Loan Bank System do not have to be approved prior to selling mortgages to FHLMC since they are regulated by and report to the Federal Home Loan Bank Board. As a result of Public Law 93-495 (12 U.S.C. 1454, Oct. 28, 1974), FHLMC is also authorized to buy mortgages from certain State-insured financial institutions.

As of September 1974, 1,224 institutions had sold mortgages to FHLMC. The number of mortgages bought and their dollar volume from inception through September 1974 are shown below.

| Year | FHA and VA mortgages | | Conventional mortgages | | Total | |
|---|---|---|---|---|---|---|
| | Number | Amount (millions) | Number | Amount (millions) | Number | Amount (millions) |
| 1970 | 16,250 | $ 325 | - | $ - | 16,250 | $ 325 |
| 1971 | 28,200 | 821 | 10,700 | 147 | 38,900 | 968 |
| 1972 | 41,650 | 803 | 23,200 | 462 | 64,850 | 1,265 |
| 1973 | 15,923 | 336 | 42,883 | 998 | 58,806 | 1,334 |
| 1974 (note a) | 10,293 | 233 | 37,693 | 1,010 | 47,986 | 1,243 |
| | 112,316 | $2,518 | 114,476 | $2,617 | 226,792 | $5,135 |

[a]First 9 months.

As of June 30, 1974, savings and loan associations had supplied 82 percent of the mortgages purchased, commercial banks 15 percent, and subcontractors (primarily mortgage bankers) 3 percent. The number of sellers is shown below.

| | |
|---|---|
| Savings and loan associations | 869 |
| Commercial banks | 259 |
| Subcontractors | 96 |
| | 1,224 |

Mortgage sellers are responsible for servicing their mortgages and may contract with other eligible FHLMC sellers or the Department of Housing and Urban Development-approved mortgagees to service mortgages sold to FHLMC. According to FHLMC officials, there are fewer delinquencies on mortgages serviced directly by the sellers than on those serviced by mortgage bankers under contract. FHLMC officials believe that the sellers, who account for the majority of servicing, do a better job than the mortgage bankers.

As of September 30, 1974, the delinquency rate on FHA and VA mortgages serviced by FHLMC sellers was 6.4 percent, whereas the rate for those serviced under contract was 7.7 percent. The delinquency rate for seller-serviced conventional mortgages was 1.9 percent. There are no conventional mortgages serviced under contract. As of June 30, 1974, the national delinquency rate for conventional mortgages serviced by mortgage bankers was 2.5 percent.

FHLMC buys single- and multifamily mortgages in the form of participations and whole loans. Most of FHLMC's conventional purchases have been under its participation program, where the seller retains an interest in the mortgage. Savings and loan associations prefer to retain a participation, or interest, in the mortgages they sell to FHLMC. For years participations in mortgages have been traded within the savings and loan industry. The enabling legislation of FHLMC, title III of the Emergency Home Finance Act of 1970 (12 U.S.C. 1454) as amended, requires those who sell mortgages to FHLMC with loan-to-value ratios in excess of 80 percent to retain a participation in the mortgage, insure the amount in excess of 80 percent, or agree to repurchase the mortgage in the event of default. A FHLMC official told us that, as a matter of policy, FHLMC also requires sellers who retain participations in mortgages to insure the amount in excess of 80 percent.

FHLMC, as discussed below, has five ongoing over-the-counter programs for buying mortgages. The minimum amount of mortgages FHLMC will contract to buy in a given day from a seller is $100,000. According to FHLMC officials, from time to time a maximum amount per seller has been imposed to control unusually high volume. This amount varied from $2.5 million weekly to $5 million daily. Sellers who are not members of the Federal Home Loan Bank System are required to pay a nonmember fee--one-half percent of the purchase contract.

For each of its five programs, FHLMC has a specific price (administered price) for buying mortgages. FHLMC officials determine the price at their weekly pricing meeting, or more often if necessary. The established price is used nationwide and determined by evaluating new loan rates around the country, the prices currently offered by mortgagees in the secondary market, and the rates required on securities in the capital market. Eligible sellers may mail or telephone their offers during workdays at the quoted price for that day.

FHLMC issues contracts and commitments in terms of dollars at specific yields, never for specific mortgages or projects, as does FNMA. The seller must originate the loan and deal with the mortgagor and/or builder because FHLMC will not become a direct competitor with any primary mortgage lender.

## Single-family purchase programs

The single-family programs consist of a conventional whole loan program, a conventional combined single-family and multifamily participation program, and a FHA and VA program.

### Single-family whole loan program

Under this program, FHLMC will issue contracts to purchase entire interests in eligible single-family conventional mortgages. The mortgages may be closed[1] after the contract is obtained; however, delivery must occur no later than 60 days after the date of the contract. All mortgages must be closed on FHLMC's uniform mortgage documents. FHLMC pays the servicer an annual rate of 3/8 percent of the unpaid principal balance of the mortgages as a servicing fee.

### Single-family and multifamily participation program

Under this program FHLMC will issue contracts to purchase from 50 to 85 percent interest in eligible single-family and multifamily conventional residential mortgages. The multifamily mortgages may not exceed 50 percent of the total amount purchased under any one contract. The mortgages must be closed before the date the contract is obtained, and delivery must be within 30 days after the date of the contract. The mortgages may be closed on the seller's documents if they are acceptable to FHLMC. The mortgages are purchased

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[1]Refers to loan closing--when all preliminary conditions to the loan have been met and when the lender authorizes, usually through a title insurance company, the recording of the trust deed or mortgage.

at an amount which does not take a servicing fee into consideration. The servicing fee becomes the difference between the actual mortgage interest rate and the yield rate.

## Multifamily purchase programs

The multifamily programs consist of a conventional whole loan program, a conventional participation program, and a FHA program.

### Multifamily whole loan program

Under this program, FHLMC will issue contracts to purchase entire interests in eligible multifamily conventional residential mortgages. The mortgages may be closed after the contract is obtained; however, delivery must be within 60 days after the date of the contract. All mortgages must be closed on FHLMC's uniform mortgage documents. FHLMC pays the servicer an annual rate of 1/4 percent of the unpaid principal balance of the mortgages up to $250,000, and 1/8 percent of the outstanding principal balance in excess of $250,000.

### Multifamily participation program

Under this program, FHLMC will issue contracts to purchase from 50 to 85 percent interest in eligible multifamily conventional residential mortgages. The mortgages must be closed before the date the contract is obtained, and delivery must be within 30 days after the date of the contract. The mortgages may be closed on the seller's documents if they are acceptable to FHLMC. The mortgages are purchased at an amount which does not take a servicing fee into consideration. The servicing fee becomes the difference between the actual mortgage interest rate and the yield rate, at which FHLMC purchases the mortgage.

## FHA and VA programs

FHLMC will issue contracts to purchase entire interests in single-family and multifamily FHA-insured mortgages and in single-family VA-guaranteed residential mortgages. The mortgages may be closed after the contract is obtained; however, delivery must occur within 60 days after the date of the contract. FHLMC pays the servicer an annual rate of 3/8 percent of the unpaid principal balance of the mortgages.

## Other programs

In addition to the five over-the-counter purchase contract programs, FHLMC has made available, on a temporary basis, commitments to purchase mortgages. The commitments differ from the over-the-counter programs in that they are for a longer period of time (6 to 24 months); the delivery of mortgages is at the option of the seller/servicer who obtains the commitments; and a fee is charged for the commitments. Except for a possible difference in interest rates, the mortgages have to meet the same requirements for over-the-counter programs.

Recent forward commitment programs include a special $3-billion program which will be funded through borrowings from the Treasury and a program in which GNMA authorized FHLMC to commit $2.5 billion, as of January 1975, for home mortgages. Both programs are for conventional single-family housing.

## SALES PROGRAMS OF FNMA AND FHLMC

FNMA and FHLMC use different techniques for selling their mortgages. Generally, FNMA sells its mortgages directly to investors whereas FHLMC sells its mortgages through participation sale certificates, which are undivided interests in mortgage pools which are managed by FHLMC. Presented below is information on the sales programs of each agency.

### FNMA

FNMA uses three methods for selling its mortgages; the condition of the money market basically determines which method will be used. When there is an excess of funds in the mortgage market and interest rates appear to be stable, FNMA uses the over-the-counter (also "open sales window" or "posted price") method. FNMA first determines the prices at which it would be willing to sell the mortgages and then announces their availability.

When an excess supply of money for mortgage investment causes the market to call upon FNMA to do a substantial volume of selling, it uses the auction method. FNMA has seldom used this method.

During periods when there is a shortage of credit and rising interest rates, FNMA will sell its mortgages when requested on an individually negotiated basis; however, very few mortgages are sold during such periods.

According to a FNMA official, FNMA prices its mortgages to create a yield slightly below the market yield to encourage investors to look to FNMA only when newly originated mortgages at the market yield are not available.

### FHLMC

FHLMC generally sells mortgages in the form or participation sale certificates. The certificate represents an undivided interest in a specific pool (approximately $50 million) of mortgages consisting of residential whole and participation mortgages purchased under FHLMC's various programs.

The certificates are sold to investors in multiples of $100,000. Investors in these certificates receive a monthly payment of principal and interest from FHLMC, which FHLMC guarantees regardless of any losses experienced by the underlying mortgages. FHLMC also acts as a servicer, transfer agent, and registrar for the certificates, which are freely transferable.

FHLMC sells the certificates directly through its Washington office and, on occasion, through one of its 13 regional offices. The rate and terms of the certificates are advertised in financial newspapers such as the Wall Street Journal. FHLMC establishes the maximum amount of certificates which it will sell during a given period.

FHLMC's records show that over half of the certificates have been sold to savings and loan associations located in New York, New Jersey, Pennsylvania, Ohio, Indiana, and Illinois. FHLMC officials said the concentration of certificate sales in these States is due, in part, to a lack of demand for mortgages and to State usury laws which restrict savings and loan associations from making mortgages at market rates.

Below are the types of institutions purchasing participation sale certificates.

| Institution | Percent of total sales |
|---|---|
| Savings and loan associations | 97.5 |
| Savings banks | 1.2 |
| Commercial banks | .9 |
| Pension funds | .2 |
| Credit unions | .1 |
| Other (note a) | .1 |
| Total | 100.0 |

[a] Includes insurance companies, cooperative banks, trust companies, and individuals.

## PAST AND FUTURE PLANS OF FNMA AND FHLMC FOR SELLING MORTGAGES

Because of an inadequate supply of mortgage credit, FNMA and FHLMC have sold a much smaller volume of mortgages than they have purchased. FNMA believes it can and will continue to purchase more mortgages than it sells as long as market conditions require it to supplement the market primarily as a buyer of mortgages. FHLMC, however, plans to increase its sales to more closely balance its buying and selling volume. Presented below is information on the agencies' past sales and future plans for selling acquired mortgages.

### FNMA

A FNMA official told us that the ideal time for FNMA to supplement the mortgage market as a seller is when the supply of funds for mortgage investment creates a demand for mortgages which cannot be satisfied by new mortgage originations. Another FNMA official said FNMA tries to make sure that it does not compete with or reduce the volume of new mortgage originations when it sells mortgages. Therefore, it sells mortgages when there is an excess of funds in the mortgage market and interest rates appear to be stable.

FNMA officials told us that there have been only a few brief periods in the market when FNMA had to supplement the market as a seller. Since 1954, FNMA's sales of mortgages have exceeded its purchases in only 2 years--1958 and 1963. The extent to which mortgage purchases have exceeded mortgage sales are shown in the following chart.

| Year | Purchases | Sales |
|---|---|---|
| | (millions) | |
| 1969 | $ 4,120 | - |
| 1970 | 5,079 | $ 20 |
| 1971 | 3,574 | 336 |
| 1972 | 3,699 | 208 |
| 1973 | 6,127 | 71 |
| 1974 (note a) | 5,685 | 4 |
| Total | $28,284 | $639 |

[a]First 9 months.

As a result of FNMA supplementing the market as a buyer of mortgages, its portfolio has grown from $2.3 billion in 1954 to $24.2 billion in 1973.

A FNMA official told us FNMA believes it can and will continue to be a net purchaser of mortgages as long as market conditions require it to supplement the market. He further said that "while FNMA has ample legal capacity to raise funds and while its officials are not concerned about moderate increases in its portfolio, they express the concern about an ever growing volume of net additions to the portfolio, particularly under stringent credit market conditions."

FHLMC

FHLMC made its only direct sale of mortgages (FHA and VA mortgages totaling about $50 million) to investors in February 1971. FHLMC officials said FHLMC sold its first participation sale certificates on September 1, 1971, and that FHLMC continued to sell on a regular basis until July 1973. From September 1971 until July 1973 FHLMC sold approximately $880 million in participation sale certificates backed by about $830 million in conventional mortgages and $50 million in FHA and VA mortgages.

FHLMC stopped issuing participation sale certificates from July 1973 to October 1974 due to an extremely tight mortgage market in which savings and loan associations were experiencing disintermediation (the process in which savers put their money into direct market instruments, such as U.S. Government bonds, and take money out or slow down additions to savings or time accounts) and, in some cases, could not handle their own local demand. FHLMC officials now believe that it was probably a bad decision to withdraw from the market and that FHLMC should have remained in the market to attract nontraditional mortgage investors, such as pension funds.

These officials informed us that FHLMC began working on a new program in October 1974 which is specifically designed to attract nontraditional mortgage investors. To establish and foster a true secondary market, FHLMC officials feel that FHLMC should be in the market at all times purchasing mortgages and selling them by issuing participation sale certificates. These officials informed us that FHLMC intends to increase its sales to more closely balance its buying and selling volume. According to FHLMC records, FHLMC has sold a higher percentage of what they buy than FNMA. Below are FHLMC's purchases and sales for 1971 through 1974.

APPENDIX

| Year | Purchases | Sales |
|---|---|---|
| | (millions) | |
| 1971 | $ 968 | $ 67 |
| 1972 | 1,265 | 493 |
| 1973 | 1,334 | 317 |
| 1974 (note a) | 1,243 | 21 |
| Total | $4,810 | $898 |

[a]First 9 months.

## TYPES OF INVESTORS PURCHASING DEBENTURES FROM FNMA AND FHLMC

### FNMA

As of September 30, 1974, FNMA had about $24 billion, or about 87 percent of its total borrowings, in debentures outstanding.

FNMA issues the debentures in bearer form and in minimum amounts of $10,000. It offers the debentures through its fiscal agent who is assisted by a nationwide group of 120 security dealers and dealer banks.

FNMA's fiscal agent listed the amounts of debentures purchased, by class of purchaser, for five debenture issues totaling $2,329,045,000. The following table lists the weighted average percentage of the five offerings purchased by the different classes of investors.

| | Percentage purchased |
|---|---|
| Type of investor: | |
| Commercial banks | 62.9 |
| Corporations | 4.4 |
| State and local governments | 3.9 |
| Savings banks | 4.4 |
| Savings and loan associations | 9.9 |
| Pension funds | 2.2 |
| Foreign accounts | 1.6 |
| Individuals | 1.2 |
| Others | 8.3 |

### FHLMC

The primary sources of FHLMC's financing has been by borrowing from the Federal Home Loan Bank System. Although FHLMC has the authority to issue its own debt obligations, it does not do so with the exception of GNMA-backed bonds discussed below. A FHLMC official said the Treasury has indicated a preference that FHLMC obtain capital through the Federal Home Loan Bank System, relying upon its established network of debt financing which has been developed over the past 30 or more years. Using this approach, FHLMC can obtain money more economically and does not have to develop its own network of debt financing. Since FHLMC does not issue obligations, we did not ascertain the purchasers of the bank system's obligations.

Another major source of FHLMC's financing has been proceeds from issuing GNMA-guaranteed mortgage-backed bonds. FHLMC has issued bonds whose principal and interest are fully guaranteed by GNMA and backed by the full faith and credit of the Treasury. These bonds are secured by FHA-insured and VA-guaranteed mortgages which FHLMC has purchased. Purchasers of FHLMC bonds as of November 30, 1973, were as follows:

| | Bonds purchased (millions) |
|---|---|
| U.S. Government accounts (note a) and Federal Reserve banks | $ 26 |
| Commercial banks | 324 |
| Mutual savings banks | 55 |
| Insurance companies | 24 |
| Savings and loan associations | 94 |
| Corporations | 19 |
| State and local governments (general funds) | 410 |
| State and local governments (pension funds) | 52 |
| Miscellaneous | 781 |
| Total | $1,785 |

[a]Government agencies and quasi-Government agencies.

## SERVICES PROVIDED TO GNMA BY FNMA

When the Congress established FNMA as a private corporation in 1968 it did not have the requisite staff or facilities to carry out its assigned work. In a letter of agreement executed September 1, 1968, between FNMA and GNMA, GNMA agreed to perform the services which FNMA needed until FNMA acquired facilities and staff. The agreement further provided that FNMA, as it became ready, would (1) perform for itself the services GNMA was performing for it and (2) perform for GNMA some, or substantially all, of the operations GNMA was performing for itself.

FNMA presently carries out the day-to-day activities relating to GNMA's special assistance, conventional mortgage purchase, mortgage-backed security, and management and liquidation programs.

The July 1, 1974, service agreement between FNMA and GNMA states what services FNMA will provide for GNMA and at what rate GNMA will reimburse FNMA.

| Services | Reimbursement |
|---|---|
| Supervising of single-family servicing | 55¢ a month for each GNMA single-family mortgage serviced by a GNMA servicer under FNMA's supervision |
| Servicing project mortgages | $84 a month for each GNMA project mortgage serviced |
| Issuing commitments | $30 for each single-family commitment issued for GNMA |
| | $150 for each multifamily commitment issued for GNMA |
| Effecting agreements related to "assumption options" (note a) | $5 for each agreement issued |
| Paying price differentials (note b) | $10 for each request for a price differential payment handled |
| Purchasing mortgages | $8.20 for each single-family mortgage purchased |
| | $700 for each project mortgage purchased |
| Selling mortgages | $7.60 for each sale of a single-family mortgage |
| | $240 for each sale of a project mortgage |
| Reviewing mortgage-backed securities | All salary and travel expenses, plus 50 percent of salary as overhead for the individuals working on the GNMA mortgage-backed securities review unit |

[a] Under such an agreement a mortgage originator holding a GNMA commitment would take delivery on the mortgage rather than delivering the mortgage to GNMA.

[b] Payments GNMA makes to originators to induce them not to deliver mortgages to GNMA.

 APPENDIX

The March 4, 1970, service agreement between GNMA and FNMA, which covered the period from January 1, 1969, to June 30, 1974, did not set forth the rate at which GNMA would pay FNMA for each service performed. GNMA paid FNMA on the basis of direct expense and an allocation or indirect expense. FNMA and GNMA, by agreement, did not pay each other a fee for services performed from September to December 31, 1968.

The following table shows GNMA's payments to FNMA.

| Fiscal year | Amount |
|---|---|
| 1969 (last 6 months) | $1,631,892 |
| 1970 | 3,223,661 |
| 1971 | 3,794,498 |
| 1972 | 5,896,675 |
| 1973 | 5,847,454 |
| 1974 | 6,085,302 |
| 1975 (note a) | 1,147,555 |

[a] First 3 months.

## EVALUATION OF IMPACT OF H.R. 11221 ON FHLMC'S OPERATIONS

H.R. 11221 (Public Law 93-495, 12 U.S.C. 1454, Oct. 28, 1974), authorizes FHLMC to purchase residential mortgages from financial institutions that have deposits or accounts insured under State laws and that have more than 20 percent of the total time and savings deposits of all such institutions in that State. Presently, Massachusetts mutual savings banks and cooperative banks are the only State financial institions eligible under this act.

FHLMC deals with federally insured institutions and relies upon reviews made by Federal regulators to insure compliance with the Federal insurance requirements. To deal with nonfederally insured financial institutions, FHLMC will have to review the State insurance programs to assure that they are fiscally and managerially sound. FHLMC will also have to continuously review those institutions approved for participation in FHLMC's programs.

According to a FHLMC official, permitting State-insured institutions in Massachusetts to sell to FHLMC will not have an immediate impact on or greatly change its operation. FHLMC already deals with mutual savings banks that account for about a third of the assets of the mutual savings banks in Massachusetts. Such savings banks are either members of the Federal Home Loan Bank System and/or federally insured.