

U.S. NEWS



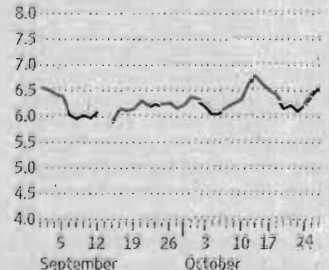
Paying Up

The premium on Fannie Mae five-year debt over comparable Treasuries



Sources: FTN Financial; HSH Associates

Average rate on 30-year fixed-rate mortgages conforming to Fannie and Freddie standards



Note: Mortgage rate for Sept. 15 not available

Homeowners gather on the steps of the Fannie Mae building in Washington Wednesday, seeking the mortgage agency's help on loans.

Mortgage Plan Isn't Cutting Rates

Borrowing Costs for Fannie Mae, Freddie Mac Are Rising Amid Debt Buyers' Jitters

BY JAMES R. HAGERTY

The U.S. takeover of Fannie Mae and Freddie Mac so far has failed to achieve one objective that government officials had envisioned: Borrowing costs for the two companies, which affect mortgage rates for consumers, are rising, not falling.

The Federal Housing Finance Agency, which regulates the government-backed providers of funding for home mortgages, seized management control of them in early September. The FHFA cited losses that could wipe out their capital, incapacitating them at a time when the government wants Fannie and Freddie to buy mortgages aggressively in an effort to drive down interest rates on home loans.

But the companies' ability to do that is constrained by continued jitters among bond investors, who insist on higher yields than they used to accept. Consumer mortgage rates have risen modestly since early September. Wednesday, the average for 30-year fixed-rate loans conforming to the standards of Fannie and Freddie was 6.64%, up from 6.34% on Sept. 5, just before the regulator took control of them, according to HSH Associates, a financial publisher.

Meanwhile, Fannie Mae said Wednesday it will write off nearly all of the \$20.6 billion in tax credits now on its books, a move that will result in a big charge against its profits.

Some mortgage lenders say Fannie and Freddie haven't done much to expand the supply of mortgage credit since the regulator took charge. "The pendulum at Fannie and Freddie has swung from too loose [in granting credit] to too tight," said **Law Barnes**, co-owner of Boulder West Financial Services, a mortgage bank in Boulder, Colo.

Fannie and Freddie say they are reconsidering the terms they offer in buying or guaranteeing loans. Freddie's new chief executive, David Moffett, said at a mortgage bankers' conference last week that his company is looking at "what is the requisite pricing for the risk we're taking." At the same conference, Fannie's new CEO, Herbert Allison, said that company is trying to figure out the *minimum* return on capital it needs to operate in a safe and sound manner. Once it has worked out that minimum, he said, Fannie will adjust its terms for buying or guaranteeing mortgages.

Fannie and Freddie are the biggest suppliers of funding for home loans in the U.S. They acquire loans made by lenders and package them into securities that can be held by the companies or sold to other investors.

One problem now is that investors remain uncertain to what degree the government will stand behind their debt in the long term. The Treasury has agreed to provide each of them

with as much as \$100 billion in capital if needed to cover losses on surging mortgage defaults. James Lockhart, director of the regulatory agency, says that is "equivalent" to a government guarantee of their debt. Mr. Lockhart told Congress last week that there was an "explicit" guarantee on the debt, but he later issued a clarification, saying it was an "effective" guarantee.

Foreign investors, particularly those in Asia who have long been among the biggest buyers of Fannie and Freddie debt, are confused by the rapid-fire policy changes and statements, according to bankers who talk to those investors. "They want clarification" on the long-run government plan for Fannie and Freddie, something that probably will come only from the next administration, says Arthur Frank, head of mortgage-securities research at Deutsche Bank in New York.

Partly because clarity is lacking, Fannie and Freddie are finding that long-term debt has become much more costly for them. The yield on Fannie's five-year notes has risen to about 1.5 percentage points above comparable Treasury bonds from one percentage point in early September.

The cost of borrowing long-term funds is so great that they are doing most of their borrowing through sales of notes maturing in a year or less. Fannie's issuance of noncallable debt of one year or longer dropped to

less than \$3 billion in October from an average of \$14 billion a month this year, according to Jim Vogel, an analyst at FTN Financial Capital Markets.

Using short-term borrowings to finance mortgage securities, which typically have maturities of five years or more, is a risky strategy, requiring the companies to use more derivative contracts to hedge against swings in interest rates.

Once highflying corporations known for generous executive pay, Fannie and Freddie have become more like government agencies. The FHFA appointed the new CEOs at Fannie and Freddie in early September. A few other senior executives have departed, and lobbyists have either been let go or told to do other things, such as merely answering questions from Congress. Decision-making at Fannie and Freddie has slowed because anything important must be referred to the regulator.

Otherwise, there have been few dramatic changes. To avoid losing vital employees, such as those with computer, accounting or mortgage-trading skills, the companies recently gave "retention" bonuses to many staffers.

—Kevin Kingsbury
contributed to this article.