



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548



COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

NOV 29 1976

B-114828

The Honorable
The Secretary of Housing
and Urban Development

Dear Mrs. Hills:

Enclosed is a copy of our testimony presented on September 20, 1976, before the Senate Committee on Banking, Housing and Urban Affairs, on the results of our study of the Government National Mortgage Association's secondary mortgage market activities. As you know, this study was made at the request of the Chairman, Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing and Urban Affairs.

Our study identified several alternatives to the Association's present practices that we believe warrant consideration because of their potential to increase revenues or otherwise improve the Association's operations.

- The Association's ability to hold mortgages during periods when interest rates are relatively high is restricted by the Office of Management and Budget's required end of the fiscal year outlay ceiling. The sale of mortgages to the Federal Financing Bank would allow the Association to adhere to the outlay ceiling and eliminate the need to sell mortgages under unfavorable market conditions.
- The Association might obtain a better return if it permitted bidders to bid on individual security issues. Presently, the Association requires bidders at security auctions to bid for all security issues offered, not for a portion thereof. As of March 31, 1976, only two large syndicates had submitted bids and subsequently purchased securities from the Association.

CED-77-16

--The Association requires a security issue to have a minimum value of \$1 million. The Association's securities have sold for a better price than individual mortgages and have attracted more nontraditional investors than have mortgage sales. If the amount required for a security issue were reduced to some amount less than \$1 million, the Association could have used the security auction method to sell some of the half billion dollars worth of mortgages sold under the whole loan auction method since January 1975.

Because of the potential for increased revenues and other improvements cited above, we recommend that you determine the desirability of

--selling the Association's mortgages directly to the Federal Financing Bank, and

--obtaining greater benefit from mortgage backed securities by (1) permitting investors to bid on individual security issues rather than all of the security issues offered and (2) reducing the minimum amount of the security issue to some amount less than \$1 million.

We shall be pleased to discuss any of the above matters with you or members of your staff and shall appreciate receiving your comments on any action taken or planned.

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House and Senate Committees on Government Operations not later than 60 days after the date of the report and the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are sending copies of this report to the four committees mentioned above and to the Chairman, Subcommittee on Housing and Urban Affairs, Senate Committee on Banking, Housing and Urban Affairs, the Director, Office of Management and Budget and the Chairman, Board of Directors, Federal Financing Bank. We are also sending copies to your Inspector General and to the President of the Government National Mortgage Association.

B-114823

We appreciate the courtesy extended to our representatives during the review.

Sincerely yours,

Henry Eschwege

Henry Eschwege
Director

Enclosure

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY
EXPECTED AT 10:00 A.M. EST
MONDAY, SEPTEMBER 20, 1976

STATEMENT OF
HENRY ESCHWEGE, DIRECTOR
COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION

BEFORE THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

ON

THE GOVERNMENT NATIONAL MORTGAGE ASSOCIATION'S
SECONDARY MORTGAGE MARKET ACTIVITIES

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

WE ARE HERE TODAY TO DISCUSS THE RESULTS OF OUR STUDY
OF THE GOVERNMENT NATIONAL MORTGAGE ASSOCIATION'S (GNMA)
SECONDARY MORTGAGE MARKET ACTIVITIES. WITH ME TODAY ARE
MR. WILBUR CAMPBELL, ASSOCIATE DIRECTOR, COMMUNITY AND
ECONOMIC DEVELOPMENT DIVISION, AND TWO OF OUR STAFF MEMBERS,
MESSRS. RALPH DOMENICK AND JAMES KENNEDY, WHO PARTICIPATED
IN THIS STUDY.

MY TESTIMONY WILL SUMMARIZE THE RESULTS OF OUR RECENTLY
COMPLETED STUDY WHICH AS YOU KNOW, WAS MADE AT THE REQUEST OF
SENATOR JOHN SPARKMAN, CHAIRMAN OF YOUR SUBCOMMITTEE ON HOUSING
AND URBAN AFFAIRS. WE WERE IN THE PROCESS OF DRAFTING A
REPORT TO THE SUBCOMMITTEE WHEN WE RECEIVED YOUR REQUEST TO

APPEAR AT THESE HEARINGS. ACCORDINGLY, THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT (HUD) AND GNMA HAVE NOT BEEN GIVEN AN OPPORTUNITY TO COMMENT ON THE INFORMATION AND OBSERVATIONS THAT FOLLOW.

SECONDARY MORTGAGE MARKET

AS YOU KNOW, MR. CHAIRMAN, THE SECONDARY MORTGAGE MARKET CONSISTS OF MORTGAGE SALE AND PURCHASE TRANSACTIONS BETWEEN OR AMONG ORGANIZATIONS WHICH ORIGINATE MORTGAGES SUCH AS SAVINGS AND LOAN ASSOCIATIONS, COMMERCIAL BANKS, MORTGAGE BANKERS, AND OTHER ORGANIZATIONS SUCH AS INSURANCE COMPANIES AND PENSION FUNDS, THAT ARE INTERESTED IN PURCHASING MORTGAGES FOR INVESTMENT PURPOSES.

A BASIC DILEMMA OF THE MORTGAGE MARKET STEMS FROM THE FACT THAT, AS INTEREST RATES RISE, DEPOSITS WITH THRIFT INSTITUTIONS DECLINE AND FUNDS AVAILABLE FOR MORTGAGE LENDING ALSO DECLINE. CONSEQUENTLY, MORTGAGE BANKERS AND OTHER ORIGINATORS WHO RELY ON THE SECONDARY MARKET FOR THE PERMANENT PLACEMENT OF THEIR MORTGAGE LOANS FIND THEIR TRADITIONAL SOURCES UNAVAILABLE.

FEDERAL PARTICIPATION IN THE SECONDARY MORTGAGE MARKET AT THE PRESENT TIME IS CARRIED OUT THROUGH ACTIVITIES OF THREE AGENCIES--GNMA, THE FEDERAL NATIONAL MORTGAGE ASSOCIATION, AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION.

GNMA'S MAJOR PURPOSES INCLUDE:

--RETARDING OR STOPPING DECLINES IN HOME BUILDING AND MORTGAGE LENDING,

--ENCOURAGING MORTGAGE ORIGINATORS TO EXPAND THEIR
ALLOCATIONS OF FUNDS FOR MORTGAGE INVESTMENTS, AND
--ATTRACTING NONTRADITIONAL SOURCES OF LONG-TERM
INVESTMENT CAPITAL TO THE MORTGAGE MARKET.

GNMA ATTEMPTS TO ACCOMPLISH ITS MISSION THROUGH THE:

--ISSUANCE OF COMMITMENTS TO PURCHASE AND THE PURCHASE
OF MORTGAGES FROM MORTGAGE ORIGINATORS,
--SALE OF SUCH MORTGAGES, AND
--GUARANTEE OF SECURITIES ISSUED BY APPROVED MORTGAGE
ORIGINATORS AND BACKED BY POOLS OF MORTGAGES.

A COMMITMENT IS AN AGREEMENT BY GNMA TO PURCHASE A
SPECIFIC TYPE OF MORTGAGE BEARING A SPECIFIED INTEREST RATE
AT A SPECIFIED PRICE FROM A MORTGAGE ORIGINATOR. THE INTEREST
RATE STIPULATED IN THE COMMITMENT IS USUALLY LOWER THAN THE
MARKET INTEREST RATE.

COMMITMENTS ARE INTENDED TO STIMULATE HOME BUYING AND
CONSTRUCTION BY ENCOURAGING MORTGAGE ORIGINATORS TO MAKE LOAN
COMMITMENTS TO HOME BUILDERS. SUCH COMMITMENTS AID THE
BUILDER IN OBTAINING CONSTRUCTION FINANCING AND ENABLE HIM
TO ADVERTISE THE AVAILABILITY OF BELOW MARKET INTEREST RATE
MORTGAGES TO HOMEBUYERS. FROM JULY 1, 1972, TO MARCH 31, 1976,
GNMA MADE COMMITMENTS TO PURCHASE ABOUT \$22.2 BILLION OF
MORTGAGES. DURING THIS TIME PERIOD GNMA SATISFIED COMMITMENTS
THROUGH THE PURCHASE OF MORTGAGES AMOUNTING TO ABOUT \$12
BILLION.

ISSUANCE OF COMMITMENTS

GNMA IS AUTHORIZED TO MAKE COMMITMENTS UNDER TWO SEPARATE AUTHORITIES--TRADITIONAL SPECIAL ASSISTANCE AND EMERGENCY SPECIAL ASSISTANCE.

TRADITIONAL AUTHORITY PERMITS GNMA TO MAKE COMMITMENTS AND TO PURCHASE CERTAIN SINGLE AND MULTIFAMILY FHA AND VA MORTGAGES UP TO A TOTAL OF \$7 3/4 BILLION OUTSTANDING AT ANY ONE TIME. GNMA'S BUDGET JUSTIFICATION INDICATES THAT IT PLANS NO NEW COMMITMENTS DURING FISCAL YEAR 1977 UNDER THE TRADITIONAL AUTHORITY.

EMERGENCY SPECIAL ASSISTANCE WAS AUTHORIZED IN 1974 BY THE EMERGENCY HOME PURCHASE ASSISTANCE ACT. THE ACT CALLED FOR A MAJOR CHANGE IN GNMA'S OPERATIONS BY AUTHORIZING GNMA TO COMMIT TO PURCHASE AND TO PURCHASE CONVENTIONAL SINGLE FAMILY MORTGAGES. GNMA WAS GIVEN \$7 3/4 BILLION IN NEW COMMITMENT AUTHORITY. GNMA'S AUTHORITY UNDER THE 1974 ACT WAS AMENDED IN 1975

--TO ADD \$10 BILLION IN COMMITMENT AND PURCHASE AUTHORITY,

AND

--TO ALLOW GNMA TO MAKE COMMITMENTS FOR CONVENTIONAL MORTGAGES ON MULTIFAMILY STRUCTURES AND CONDOMINIUMS.

FUNDS AUTHORIZED HOWEVER HAD TO BE RELEASED BY AN APPROPRIATION ACT AND ONLY \$5 OF THE \$10 BILLION WAS APPROPRIATED IN 1976.

THE COMMITMENT TO PURCHASE MORTGAGES SPECIFIES THE PRICE THAT GNMA AGREES TO PAY WHEN IT PURCHASES MORTGAGES ISSUED UNDER BOTH THE TRADITIONAL AND EMERGENCY PROGRAMS. FOR EXAMPLE, GNMA MAY MAKE A COMMITMENT TO PAY THE ORIGINATOR 98 PERCENT OF THE UNPAID BALANCE OF THE LOAN AT THE TIME IT IS DELIVERED FOR PURCHASE. IN EFFECT, GNMA AGREES TO PURCHASE THE MORTGAGES AT A 2 PERCENT DISCOUNT. GNMA HAS MADE COMMITMENTS AT PURCHASE PRICES RANGING FROM 96 TO 100 UNDER ITS CURRENT PROGRAMS.

GNMA OFFICIALS HAVE SAID THAT THE PRIMARY CONSIDERATION IN ESTABLISHING THE PURCHASE PRICE IS THAT THE DISCOUNT WILL COVER GNMA'S COSTS, TO THE EXTENT THIS IS FEASIBLE UNDER PREVAILING MARKET CONDITIONS.

NOT ALL COMMITMENT CONTRACTS ISSUED BY GNMA RESULT IN MORTGAGE PURCHASES. FROM JULY 1, 1972, THROUGH MARCH 31, 1976, COMMITMENTS TOTALING ABOUT \$6.6 BILLION WERE SATISFIED WHEN

--THE ORIGINATOR CANCELLED HIS COMMITMENT OR

ALLOWED IT TO EXPIRE, OR WHEN

--THE ORIGINATOR OR OTHER PRIVATE INVESTOR ASSUMED THE COMMITMENT.

THESE ACTIONS RELEASE GNMA FROM ITS OBLIGATION TO PURCHASE MORTGAGES.

ACCORDING TO GNMA, THE MAIN REASON FOR CANCELLATIONS OF COMMITMENTS HAS BEEN THE BUILDERS' INABILITY TO COMPLETE CONSTRUCTION.

UNDER AN ASSUMPTION, ALSO REFERRED TO AS A BUY-BACK, THE ORIGINATOR AGREES TO RETAIN THE MORTGAGES PROVIDED THAT GNMA PAYS THE DIFFERENCE BETWEEN THE COMMITMENT PRICE AND GNMA'S ESTIMATE OF THE CURRENT MARKET PRICE.

FOR EXAMPLE, GNMA ISSUES A COMMITMENT TO PURCHASE A CONVENTIONAL MORTGAGE, BEARING AN INTEREST RATE OF 7 1/2 PERCENT, FROM AN ORIGINATOR AT 98 AND THE PUBLISHED GNMA ESTIMATED MARKET PRICE IS 92. THE ORIGINATOR MAY KEEP THE MORTGAGE AND RECEIVE THE 6 POINT (98 - 92) DIFFERENTIAL FROM GNMA. FROM JULY 1, 1972, TO MARCH 31, 1976, COMMITMENTS TO PURCHASE FHA AND VA MORTGAGES IN THE AMOUNT OF \$5.4 BILLION AND CONVENTIONAL MORTGAGES IN THE AMOUNT OF \$800 MILLION HAVE BEEN SATISFIED BY ASSUMPTIONS.

A MAJOR PURPOSE OF GNMA'S COMMITMENTS IS TO RETARD OR STOP DECLINES IN HOUSING CONSTRUCTION AND MORTGAGE LENDING. HUD OFFICIALS LOOK TO THE NUMBER OF HOUSING STARTS AND MORTGAGE INTEREST RATES AS KEY INDICATORS OF THE CONDITION OF THE HOUSING INDUSTRY.

TO OBSERVE THE TIMELINESS OF GNMA'S ISSUANCE OF COMMITMENTS, WE STUDIED THE RELATIONSHIP BETWEEN THE AMOUNT OF GNMA'S COMMITMENTS FOR BOTH SINGLE- AND MULTIFAMILY

MORTGAGES AND CHANGES IN THE NUMBER OF SINGLE- AND MULTIFAMILY HOUSING STARTS AND INTEREST RATES FOR CONVENTIONAL MORTGAGES FROM JULY 1, 1972, THROUGH DECEMBER 31, 1975.

GNMA USUALLY RESPONDED TO DECLINES IN HOUSING STARTS AND INCREASES IN MORTGAGE INTEREST RATES BY INCREASING THE AMOUNT OF COMMITMENTS ISSUED AND MAKING AVAILABLE BELOW MARKET INTEREST RATE MORTGAGES.

SALE OF MORTGAGES

THE SECOND GNMA ACTIVITY THAT I WOULD LIKE TO DISCUSS IS THE SELLING OF MORTGAGES AND MORTGAGE-BACKED SECURITIES. THESE SALES ARE MADE, IN PART, TO FINANCE GNMA'S PURCHASE ACTIVITIES.

FROM THE BEGINNING OF FISCAL YEAR 1973 THROUGH DECEMBER 31, 1975, GNMA HAD REVENUES OF \$5.8 BILLION OF WHICH ABOUT 75 PERCENT (\$4.4 BILLION) CAME FROM MORTGAGE AND SECURITY SALES. THROUGH THESE SALES, GNMA MINIMIZES ITS BORROWINGS FROM THE TREASURY BY SUBSTITUTING PRIVATE FINANCING FOR FEDERAL FUNDS.

BECAUSE GNMA GENERALLY PURCHASES MORTGAGES WITH BELOW MARKET INTEREST RATES AT A HIGHER PRICE THAN PRIVATE INVESTORS ARE WILLING TO PAY, IT USUALLY SUFFERS A LOSS WHEN IT SELLS THESE MORTGAGES ON THE PRIVATE MARKET. THE BEST GNMA CAN HOPE TO DO IS TO MINIMIZE THESE LOSSES BY TIMING ITS SALES TO TAKE ADVANTAGE OF THE MOST FAVORABLE MARKET CONDITIONS.

THE AMOUNT OF MORTGAGES AND SECURITIES WHICH GNMA SELLS IS INFLUENCED BY THE NET OUTLAY CEILING ESTABLISHED BY THE OFFICE OF MANAGEMENT AND BUDGET (OMB). WHEN GNMA'S EXPENDITURES EXCEED ITS REVENUES IT RESULTS IN A NET OUTLAY WHICH ADDS TO THE NATIONAL DEBT. BECAUSE OF THE OUTLAY CEILING IMPOSED BY OMB, GNMA MAY HAVE TO SELL MORTGAGES TO STAY WITHIN THE CEILING EVEN THOUGH LOSSES COULD POSSIBLY BE REDUCED IF SALES WERE DELAYED UNTIL MARKET CONDITIONS IMPROVED.

DURING FISCAL YEAR 1975 GNMA'S EXPENDITURES EXCEEDED THEIR INITIAL BUDGET ESTIMATES BECAUSE OF SUBSTANTIAL PURCHASES MADE UNDER THE EMERGENCY HOME PURCHASE ASSISTANCE ACT OF 1974. TO STAY WITHIN THE BUDGETED OUTLAY CEILING, GNMA NEEDED TO OBTAIN REVENUES OF ABOUT \$3.2 BILLION FROM MORTGAGE SALES DURING THE FISCAL YEAR. HOWEVER, PREVAILING MARKET INTEREST RATES DURING THE YEAR WERE GENERALLY IN EXCESS OF 8 3/4 PERCENT. TO AVOID THE POTENTIAL LARGE LOSSES THAT WOULD RESULT FROM GNMA MORTGAGE SALES, OMB ALLOWED GNMA TO INCREASE ITS BUDGET OUTLAY CEILING BY \$1.9 BILLION. GNMA, THEREFORE, ONLY HAD TO REALIZE REVENUES OF \$1.3 BILLION FROM MORTGAGE SALES DURING FISCAL YEAR 1975.

OUR STUDY OF THE RELATIONSHIP OF GNMA'S SALE OF MORTGAGES AND SECURITIES TO CHANGES IN THE AVERAGE MONTHLY INTEREST RATES DURING THE 3 1/2 YEAR PERIOD ENDING

DECEMBER 1975, INDICATED THAT, WITHIN THE CONFINES OF THE OMB OUTLAY CEILING, GNMA TIMED ITS MORTGAGE AND SECURITIES SALES RELATIVELY WELL.

GNMA DISPOSED OF SINGLE- AND MULTIFAMILY MORTGAGES WORTH ABOUT \$10.2 BILLION DURING THE PERIOD JULY 1, 1972, THROUGH MARCH 31, 1976. ABOUT \$9.1 BILLION OF THESE MORTGAGES REPRESENT SINGLE-FAMILY MORTGAGES WHICH WERE SOLD UNDER FIVE DIFFERENT SALES METHODS. TWO OF THE SALES METHODS--SECURITY AUCTIONS AND WHOLE LOAN AUCTIONS--WERE USED TO SELL MOST OF THE SINGLE-FAMILY MORTGAGES--ABOUT \$7 BILLION.

UNDER THE SECURITY AUCTION METHOD, GNMA SELECTS FROM ITS PORTFOLIO A NUMBER OF MORTGAGES, REFERRED TO AS A BLOCK, BEARING THE SAME INTEREST RATE. EACH BLOCK MUST HAVE AN AGGREGATE UNPAID PRINCIPAL OF \$1 MILLION AND BE SERVICED BY ONLY ONE MORTGAGE SERVICER. WHEN IT HOLDS A SECURITY AUCTION, GNMA GENERALLY OFFERS A NUMBER OF SECURITY ISSUES FOR SALE WHICH ARE BACKED BY BLOCKS OF MORTGAGES. GNMA REQUIRES THE BIDDERS TO SUBMIT BIDS FOR THE TOTAL AMOUNT OF ISSUES BEING OFFERED. BIDS ON INDIVIDUAL ISSUES ARE NOT ACCEPTED.

A WHOLE LOAN AUCTION DIFFERS FROM A SECURITY AUCTION IN THAT THE ACTUAL MORTGAGES ARE SOLD RATHER THAN MORTGAGE-BACKED SECURITIES. GNMA WILL SELL TO THE HIGHEST BIDDER A MORTGAGE OR A PACKAGE OF MORTGAGES PROVIDED THAT THE HIGHEST BID WILL PRODUCE AT LEAST THE MINIMUM YIELD ACCEPTABLE TO GNMA.

GNMA USED FOUR DIFFERENT SALES METHODS IN DISPOSING OF ABOUT \$1.1 BILLION OF MULTIFAMILY MORTGAGES DURING THE PERIOD JULY 1, 1972, TO MARCH 31, 1976. THE WHOLE LOAN AUCTION METHOD WAS USED TO DISPOSE OF MORTGAGES WORTH \$676 MILLION.

SECURITIES TRANSACTIONS

ANOTHER OF GNMA'S MISSIONS IS TO ATTRACT NEW INVESTORS (NONTRADITIONAL) SUCH AS INSURANCE COMPANIES AND PENSION FUNDS INTO THE MORTGAGE MARKET, THEREBY INCREASING THE AMOUNT OF INVESTMENT CAPITAL AVAILABLE FOR MORTGAGE ORIGINATIONS. THIS IS PRIMARILY ACCOMPLISHED BY (1) GUARANTEEING SECURITIES ISSUED BY MORTGAGE ORIGINATORS WHICH ARE BACKED BY POOLS OF THEIR MORTGAGES AND (2) SELLING SECURITIES BACKED BY GNMA-HELD MORTGAGES. AS OF MARCH 31, 1976, OUTSTANDING MORTGAGE-BACKED SECURITIES GUARANTEED BY GNMA HAD A VALUE OF ABOUT \$23 BILLION.

OUR ANALYSIS SHOWED THAT GNMA HAS BEEN MORE SUCCESSFUL IN ATTRACTING NONTRADITIONAL INVESTMENT CAPITAL THROUGH THE SALE OF SECURITIES BACKED BY GNMA-HELD MORTGAGES AND BY GUARANTEEING SECURITIES ISSUED BY MORTGAGE ORIGINATORS THAN THROUGH THE SALE OF INDIVIDUAL MORTGAGES.

ALL OF GNMA'S METHODS OF SELLING MORTGAGES OR SECURITIES INVOLVE THE ESTIMATION OF THE CURRENT MARKET PRICE BY GNMA.

GNMA'S ESTIMATE OF MARKET PRICE IS USED EITHER FOR DETERMINING THE MINIMUM ACCEPTABLE BID OR SETTING THE SALES PRICE DEPENDING ON THE SALES METHOD USED. THE ACTUAL SELLING PRICE FOR MOST MORTGAGES SOLD IS DETERMINED, HOWEVER, BY THE BIDS RECEIVED.

GNMA HAS NO SET FORMULA FOR ESTABLISHING THE EXACT PRICE. GNMA ESTIMATES THE CURRENT MARKET PRICE BY ANALYZING MARKET CONDITIONS FOR OTHER MORTGAGES, SECURITIES, AND INSTRUMENTS COMPARABLE TO THOSE IT IS OFFERING FOR SALE.

SALES ALTERNATIVES

WE IDENTIFIED A NUMBER OF ALTERNATIVES THAT WE BELIEVE WARRANT STUDY BY GNMA BECAUSE OF THEIR POTENTIAL TO INCREASE REVENUES OR OTHERWISE IMPROVE GNMA'S OPERATIONS.

GNMA'S ABILITY TO HOLD MORTGAGES DURING PERIODS WHEN INTEREST RATES ARE RELATIVELY HIGH IS RESTRICTED BY OMB'S REQUIRED END OF THE FISCAL YEAR OUTLAY CEILING. THE SALE OF GNMA MORTGAGES DIRECTLY TO THE FEDERAL FINANCING BANK WOULD ALLOW GNMA TO ADHERE TO THE OMB IMPOSED OUTLAY CEILING. SALES TO THE BANK WOULD ELIMINATE THE NEED TO SELL THE MORTGAGES IN THE PRIVATE MARKET UNDER UNFAVORABLE CONDITIONS AND COULD PROVIDE AN OPPORTUNITY TO MINIMIZE LOSSES.

AS YOU KNOW, MR. CHAIRMAN, GNMA WAS AUTHORIZED TO SELL MORTGAGES AND MORTGAGE-BACKED SECURITIES TO THE FEDERAL

FINANCING BANK BY AMENDMENTS IN 1974 AND 1975 TO THE NATIONAL HOUSING ACT. ALTHOUGH GNMA HAS NEVER MADE SUCH SALES, WE UNDERSTAND THAT THE BANK AND GNMA HELD SEVERAL MEETINGS TO DISCUSS THE MATTER. AGREEMENT COULD NOT BE REACHED, HOWEVER, ON HOW LONG THE BANK WOULD HOLD THE MORTGAGES. GNMA WANTED THE BANK TO RESELL THE MORTGAGES TO THE PRIVATE MARKET IN THE NEAR FUTURE WHILE THE BANK FAVORED LONG-TERM HOLDING OF THE MORTGAGES. IN JULY 1975, OMB DECIDED THAT MORTGAGES WOULD NOT BE SOLD TO THE BANK. OMB DID ACT TO INCREASE HUD'S OUTLAY CEILING SO THAT GNMA WOULD NOT BE FORCED TO SELL THE MORTGAGES.

TWO POSSIBLE NEGATIVE FEATURES OF THE SALE OF MORTGAGES TO THE FEDERAL FINANCING BANK WHICH MUST BE CONSIDERED ARE:

--BECAUSE THE BANK FINANCES ITS PURCHASES BY TREASURY BORROWINGS, THE PURCHASE OF MORTGAGES BY THE BANK WOULD RESULT IN A DIRECT INCREASE IN THE PUBLIC DEBT WHICH COULD IMPACT ON INTEREST RATES FOR OTHER PUBLIC DEBT ISSUES, AND

--IF INTEREST RATES CONTINUE TO RISE, THE FEDERAL FINANCING BANK MIGHT BE FORCED TO SELL THE MORTGAGES AT A GREATER LOSS THAN GNMA WOULD HAVE INCURRED.

WITH REGARD TO GNMA'S SECURITY AUCTION WE NOTED TWO AREAS THAT COULD BE IMPROVED.

WHEN CONDUCTING SECURITY AUCTIONS, GNMA REQUIRES THE POTENTIAL INVESTORS TO SUBMIT A BID FOR ALL OF THE SECURITY ISSUES OFFERED. AS OF MARCH 31, 1976, ONLY TWO LARGE SYNDICATES HAD SUBMITTED BIDS TO GNMA AT SECURITY AUCTIONS. ALL OF THE SECURITIES OFFERED WERE PURCHASED BY EITHER OF THESE TWO SYNDICATES. FOR ALL SECURITIES PURCHASED THROUGH MARCH 31, 1976, THE SYNDICATES PAID GNMA ABOUT \$2.8 BILLION AND RESOLD THEM FOR A GROSS PROFIT OF \$15.5 MILLION (ABOUT 1/2 OF ONE PERCENT OF THE PURCHASE PRICE). GNMA COULD OBTAIN A BETTER RETURN IF IT PERMITTED BIDDERS TO BID ON INDIVIDUAL SECURITY ISSUES.

FINALLY, GNMA REQUIRES THAT A SECURITY ISSUE HAVE A MINIMUM VALUE OF \$1 MILLION. GNMA OFFICIALS INDICATED TO US THAT THEY COULD HAVE USED THE SECURITY AUCTION METHOD FOR SOME OF THE HALF BILLION DOLLARS WORTH OF MORTGAGES SOLD UNDER THE WHOLE LOAN AUCTION METHOD SINCE JANUARY 1975, IF THE MINIMUM SECURITY ISSUE HAD BEEN REDUCED TO \$100,000. WE BELIEVE THAT GNMA NEEDS TO CONSIDER REDUCING THE AMOUNT REQUIRED FOR A SECURITY ISSUE TO SOME AMOUNT LESS THAN \$1 MILLION BECAUSE (1) GNMA SECURITIES HAVE BEEN SOLD FOR A BETTER PRICE THAN THE INDIVIDUAL MORTGAGES AND (2) SECURITIES' SALES HAVE ATTRACTED MORE NONTRADITIONAL INVESTORS THAN HAVE MORTGAGE SALES.

TO SUMMARIZE WE BELIEVE THAT THE SECRETARY OF HUD SHOULD DETERMINE THE DESIRABILITY OF

- SELLING GNMA MORTGAGES DIRECTLY TO THE FEDERAL FINANCING BANK, AND
- OBTAINING GREATER BENEFIT FROM MORTGAGE BACKED SECURITIES BY (1) PERMITTING INVESTORS TO BID ON INDIVIDUAL SECURITY ISSUES RATHER THAN ALL OF THE SECURITY ISSUES OFFERED AND (2) REDUCING THE MINIMUM AMOUNT OF THE SECURITY ISSUE TO SOME AMOUNT LESS THAN \$1 MILLION.

IN CONCLUSION, I WOULD LIKE TO POINT OUT THAT AS A SEPARATE STUDY WE HAVE JUST STARTED TO INQUIRE INTO THE EFFECT OF FEDERAL CREDIT ASSISTANCE ON THE HOUSING MARKET. WE PLAN TO ADDRESS ISSUES SUCH AS:

- MEASUREMENTS OF THE EFFECTIVENESS OF FEDERAL INTERVENTION IN THE SECONDARY MARKET VIA THE EMERGENCY SPECIAL ASSISTANCE PROGRAMS,
- INCOME LEVELS OF AND PRICES PAID FOR HOMES BY PERSONS PARTICIPATING IN THE GNMA EMERGENCY SPECIAL ASSISTANCE PROGRAMS, AND
- THE SELECTION OF HOME BUILDERS AND MORTGAGE ORIGINATORS PARTICIPATING IN THE PROGRAM.

MR. CHAIRMAN, THIS COMPLETES MY PREPARED STATEMENT. WE WILL BE HAPPY TO RESPOND TO YOUR QUESTIONS.