

**FEDERAL RESERVE BANK
OF NEW YORK**

Fiscal Agent of the United States

[Circular No. 4177]
[December 30, 1954]

**Prospective Cash Offering of Series ML Notes
of Federal National Mortgage Association**

*To all Banking Institutions, and Others Concerned,
in the Second Federal Reserve District:*

On January 11, 1955, the Treasury Department, through the facilities of the Federal Reserve Banks as fiscal agents of the United States, will make a public cash offering of \$500,000,000, or thereabouts, of Series ML (Management and Liquidating) Notes of the Federal National Mortgage Association.

The interest rate and maturity of the issue will be announced next week by the Treasury Department. A copy of that announcement will be sent to you as soon as it becomes available. Subscription books for this offering will be open at this Bank on January 11; copies of the offering circular and subscription forms will be mailed to reach you on or before that date.

The text of a FNMA statement on the offering, made public today, is printed on the reverse side of this circular. Enclosed is a copy of the general prospectus issued by FNMA, which gives data concerning FNMA, its background and operations, capitalization, borrowing authority and financial statement.

Additional copies of this circular and of the enclosure will be furnished upon request.

ALLAN SPROUL,
President.

(OVER)

FEDERAL NATIONAL MORTGAGE ASSOCIATION
WASHINGTON 25, D. C.

FNMA-P.R. #102

FOR RELEASE

Thursday, A. M.

December 30, 1954

The Federal National Mortgage Association has entered into an agreement with the Treasury Department to handle a public cash offering of \$500,000,000, or thereabouts, of its Series ML (Management and Liquidating) Notes it was announced today by FNMA President J. Stanley Baughman. This is the first step taken by FNMA, as provided by the Congress, to substitute private financing for borrowings from the Treasury.

Proceeds of the sale of the Series ML Notes will be used to reduce the indebtedness of the Association to the U. S. Treasury. According to Mr. Baughman this issue is the only one planned for the present.

The FNMA offering will be made by the Treasury Department on January 11 through the facilities of the Federal Reserve Banks as fiscal agents of the United States. The channels and procedures to be followed in marketing the notes are virtually the same as those used by the Treasury Department in offering public debt securities.

The notes will be short-term with a maturity of approximately three years. The maturity date and interest rate of the issue will be stated in an announcement of the offering to be made by the Treasury Department next week. Subscription books for the FNMA offering will be open on January 11, 1955, and may be closed without notice. Payment is scheduled for January 20.

In his announcement Mr. Baughman said that "one of the favorable features of this issue is the arrangement FNMA has made with the Treasury Department that will enable qualified subscribing banks to obtain credits to their Treasury Tax and Loan Accounts in amounts equal to notes allotted and paid for, by following the procedure to be prescribed in the forthcoming Treasury circular announcing the offering. The notes may be pledged as collateral to Treasury Tax and Loan Accounts."

The FNMA notes are lawful investments and may be used as security for all fiduciary, trust and public funds, the investment or deposit of which is under the authority and control of the United States or any officer or officers thereof. The FNMA Charter Act makes no provision for specific exemption of these notes from Federal, state, municipal, or local taxation.

Mr. Baughman also declared "That these notes may be purchased by and held without limit by National banks since the law exempts obligations of FNMA from restrictions and limitations generally applicable to investment securities." The FNMA ML Notes will not be guaranteed by the United States. FNMA has received assurance from the Treasury Department that it will lend to FNMA any amount that may be necessary to meet its obligations. In connection with this Mr. Baughman pointed out that "FNMA has an excellent earning record over a period of years with a net income of \$88,000,000 shown for the past three (3) fiscal years based on a net profit of \$29,000,000 in 1952; \$34,000,000 in 1953 and \$25,000,000 in 1954."

(Please refer to attached prospectus for additional data including FNMA background and operations, capitalization, borrowing authority and financial statement)

**FEDERAL
NATIONAL MORTGAGE
ASSOCIATION**

General Prospectus Concerning
**MANAGEMENT AND LIQUIDATING
FUNCTIONS (ML) NOTES**

(Public Issues)

December 30, 1954

**Address of Principal Office:
811 Vermont Avenue, N. W.
Washington, D. C.**

6010-1-4

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FEDERAL NATIONAL MORTGAGE ASSOCIATION

General Prospectus Concerning

MANAGEMENT AND LIQUIDATING FUNCTIONS (ML) NOTES

(Public Issues)

Principal and interest payable at any Federal Reserve Bank or branch or at the Office of the Treasurer of the United States. Issued in bearer form only in denominations of \$1,000, \$5,000, \$10,000, \$100,000, and \$1,000,000.

Purpose of the issues—Net proceeds of sale of notes will be paid to the Secretary of the Treasury in reduction of the Association's indebtedness under the Management and Liquidating Functions.

The Federal National Mortgage Association—The FNMA is a corporate instrumentality of the United States. It is authorized to perform the following three separate functions under the FNMA Charter Act (approved August 2, 1954): (1) to manage and liquidate the existing mortgage portfolio as of the close of October 31, 1954 (the "Management and Liquidating Functions"); (2) to perform special assistance functions in the purchase of certain mortgages, as directed by the President of the United States (the "Special Assistance Functions"); and (3) to provide supplementary assistance to the secondary market in guaranteed and insured home mortgages (the "Secondary Market Operations"). A detailed description of FNMA's operations and of its ML Notes is contained in the following pages.

Relationship with the Treasury Department—Offerings for public subscription of issues of FNMA ML Notes will be made from time to time through the facilities of the U. S. Treasury Department, and the Federal Reserve Banks as fiscal agents of the United States, in the same manner as offerings of public debt securities. The Treasury will make loans to FNMA, if needed, to provide for interest payments and repayment of principal at maturity of the ML Notes. The ML Notes, together with the interest thereon, are not guaranteed by the United States and do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the Association. The ML Notes are the obligations of the Association under the Management and Liquidating Functions provided for by the FNMA Charter Act.

The FNMA will not issue additional ML Notes pursuant to section 306(b) of the Charter Act if, at the time of such proposed issuance and as a consequence thereof, the resulting aggregate amount of its outstanding ML Notes issued pursuant to section 306(b) would exceed eighty percent of the amount of Association's ownership under the ML separate accountability, free from any liens or encumbrances, of cash, FHA-insured mortgages, VA-guaranteed mortgages, and bonds or other obligations of or guaranteed as to principal and interest by the United States.

Outstanding Features of ML Notes—The ML Notes are issued pursuant to section 306(b) of the FNMA Charter Act. They are lawful investments and may be accepted as security for all fiduciary, trust, and public funds under the authority and control of the United States or any officer or officers thereof. National banks may invest in these notes without regard to the statutory limitations and restrictions generally applicable to investment securities. The notes are eligible as collateral for Treasury tax and loan accounts.

Tax status—The income derived from the notes does not have any exemption, as such, under the Internal Revenue Code of 1954. The notes are subject to Federal estate, gift or other excise taxes. The FNMA Charter Act does not contain any specific exemption with respect to taxes now or hereafter imposed on the principal of or interest on the notes by any State, or any of the possessions of the United States, or by any local taxing authority.

Examination and audit—The FNMA is periodically examined by a regular auditing staff maintained by the Association. In accordance with the Government Corporation Control Act, the FNMA is also audited for each fiscal year by the General Accounting Office. Reports of such audits are made annually to the Congress and are available to the public.

Further information regarding the operations of FNMA may be obtained from the Association's principal office at 811 Vermont Avenue, N. W., Washington, D. C.

BACKGROUND AND OPERATIONS PRIOR TO NOVEMBER 1, 1954

The Federal National Mortgage Association, hereinafter referred to as "FNMA," was incorporated on February 10, 1938, pursuant to the then title III of the National Housing Act. It is at the present time a constituent agency of the Housing and Home Finance Agency. The FNMA's principal initial objective was to assist in the establishment of a market for the purchase and sale of residential mortgages insured by the Federal Housing Administration. Later, in 1948, FNMA's powers were broadened to enable it to assist in the establishment of an adequate market for the purchase and sale of residential mortgages guaranteed by the Veterans Administration. Through the years FNMA has played a significant role in providing aid to meet the financing needs of the home building economy through its purchase of Government-insured and -guaranteed mortgages.

From organization through October 31, 1954, FNMA purchased insured and guaranteed mortgages aggregating \$4,444 million and sold such mortgages totaling \$1,542 million, while repayments and other credits amounted to \$534 million.

As of the opening of business on November 1, 1954, the mortgage portfolio of FNMA consisted of 332,173 insured and guaranteed mortgages amounting to \$2,368 million, on which the Association's average interest return was 4.11 percent per annum. Outstanding commitments to purchase mortgages aggregated \$603 million on that date.

Under the FNMA Charter Act and as explained below the management and liquidation of the \$2,368 million of insured and guaranteed mortgages and of the \$603 million of outstanding commitments constitute complete and separate functions of FNMA. Separate accountability for these functions is required by law.

OPERATIONS UNDER NEW CHARTER

Title II of the Housing Act of 1954 (Public Law 560, 83rd Congress, approved August 2, 1954), revised title III of the National Housing Act and rechartered the FNMA. The revised title III is given the short title "Federal National Mortgage Association Charter Act," hereinafter referred to as the "Charter Act." It is a fundamental objective of the Charter Act that the operations of FNMA shall be financed with private capital to the maximum extent feasible. Heretofore operating funds have been borrowed from the Treasury, except for two series of notes that were issued in 1938 and 1939.

The Charter Act empowers FNMA to perform three separate functions and imposes separate accountability: (1) to manage and liquidate the existing mortgage portfolio as of the close of October 31, 1954 (the "Management and Liquidating Functions"); (2) to perform special assistance functions in the purchase of certain mortgages, as directed by the President of the United States (the "Special Assistance Functions"); and (3) to provide supplementary assistance to the secondary market in guaranteed and insured home mortgages (the "Secondary Market Operations").

The three new operations commenced on November 1, 1954. All of the mortgages on hand as of the close of October 31, 1954 are being held under the separate accountability of the Management and Liquidating Functions. Mortgages acquired under the Special Assistance Functions are also held under separate accountability, as are mortgages purchased under the Secondary Market Operations. Accordingly, it is to be noted that Federal National Mortgage Association's operations are now divided into three parts, each with its own assets and liabilities and separate borrowing authority. The operations for each of the three functions are complete, separate, and distinct from the others—as though there were three separate corporations.

CAPITALIZATION AND BORROWING AUTHORITY

The capital of the Association represented by preferred stock and common stock is related only to the Secondary Market Operations; it has no connection with the Management and Liquidating Functions or the Special Assistance Functions.

As of the commencement of the Secondary Market Operations on November 1, 1954, there was issued to the Secretary of the Treasury FNMA preferred stock with a par value of \$92,820,304.97. Mortgage lenders using the facilities of the Association's Secondary Market Operations are required by law to subscribe for FNMA common stock to the extent of not less than 3 percent of the unpaid principal amount of mortgages they sell to the Association. To provide for the further financing of the Secondary Market Operations the Association is authorized to offer a specific series of obligations (relating only to the Secondary Market Operations) for sale to private investors (or, under certain conditions, to the Secretary of the Treasury) in an aggregate amount outstanding at any one time not in excess of ten times the capital, surplus, and other items of net worth related to the Secondary Market Operations.

The Association does not plan to offer at this time any obligations relating to the Secondary Market Operations.

There is no capitalization associated with the Special Assistance Functions or the Management and Liquidating Functions. The Special Assistance Functions are financed entirely through borrowings from the Secretary of the Treasury.

MANAGEMENT AND LIQUIDATING FUNCTIONS UNDER WHICH ML NOTES ARE TO BE ISSUED

The Management and Liquidating Functions are financed in two ways: (1) borrowing from the Secretary of the Treasury, and (2) the sale of (ML) obligations to private investors. To enable the Association to substitute private financing for Treasury borrowings otherwise required to carry mortgages held under the Management and Liquidating Functions the Charter Act

authorizes the Association to issue for sale to private investors, on approval of the Secretary of the Treasury, and have outstanding at any one time ML obligations having such maturities and bearing such rate or rates of interest as may be determined by the Association with the approval of the Secretary of the Treasury.

The Federal National Mortgage Association will not issue additional ML Notes pursuant to section 306(b) of the Charter Act if, at the time of such proposed issuance and as a consequence thereof, the resulting aggregate amount of its outstanding ML Notes issued pursuant to section 306(b) would exceed eighty percent of the amount of Association's ownership under the ML separate accountability, free from any liens or encumbrances, of cash, FHA-insured mortgages, VA-guaranteed mortgages, and bonds or other obligations of or guaranteed as to principal and interest by the United States.

It is to be noted also that the Charter Act specifically authorizes the Association to borrow from the Secretary of the Treasury in an amount outstanding at any one time sufficient to enable the Association to carry out the Management and Liquidating Functions. FNMA will exercise this borrowing authority, if there be any need therefor, to provide for the timely payment of interest and repayment of principal at maturity of its ML Notes. To clarify the applicability of the Association's authority to borrow from the Secretary of the Treasury to carry out the Management and Liquidating Functions prescribed by section 306 of the Charter Act there are reproduced below the FNMA letter of December 6, 1954 addressed to the Secretary of the Treasury and his reply dated December 7, 1954:

The Honorable
THE SECRETARY OF THE TREASURY
Washington 25, D. C.

Re: *FNMA Series ML (Management and Liquidating) Notes*
Section 306(b) of the Federal National Mortgage Association Charter Act
(Title III of the National Housing Act, as amended by Title II of Public
Law 560, 83rd Congress, approved August 2, 1954).

Dear Mr. Secretary:

To facilitate the marketing of Series ML Notes of the Association to be issued to the investing public pursuant to section 306(b) of the said Charter Act, the Association proposes to warrant to prospective investors that it will exercise its borrowing authority with the Secretary of the Treasury under section 306(d) of the Charter Act at any time, if there be need therefor, in order to maintain timely payments of interest and principal with respect to its obligations to be issued under section 306(b).

The borrowing authority under section 306(d) provides, in substance, that the Association may issue to the Secretary of the Treasury its obligations in an amount outstanding at any one time sufficient to enable the Association to carry out its "Management and Liquidating Functions" under section 306, and also prescribes that the Secretary of the Treasury is authorized to purchase any obligations of the Association to be issued under section 306(d).

The Association is of the opinion that its warranty will provide for a proper application of the borrowing authority of the Association under section 306(d) in view of the following provisions (summarized in pertinent part) of the Charter Act:

Subsection (a) of Section 307 provides, with respect to the "Management and Liquidating Functions" to be performed by the Association, that the Association "shall establish and at all times maintain separate accountability . . .";

Subsection (b) of Section 306 provides that to assure that private financing will be substituted for Treasury borrowings otherwise required to carry mortgages held by the Association under its "Management and Liquidating Functions", the Association is authorized to issue, with the approval of the Secretary of the Treasury, and have outstanding at any time "obligations having such maturities and bearing such rates of interest as may be determined . . .". The subsection further prescribes that the proceeds of sale of any such obligations shall be paid to the Secretary of the Treasury "in reduction of the indebtedness of the Association to the Secretary of the Treasury . . .";

Subsection (b) of Section 307 provides that in connection with the aforesaid separate accountability of the Association's "Management and Liquidating Functions", there "shall be no recourse to the capitalization of the Association . . .";

Subsection (c) of Section 307 provides that "All of the benefits and burdens incident to the administration" of the "Management and Liquidating Functions" of the Association, after expenses and the like, "shall inure solely to the Secretary of the Treasury . . .".

In the circumstances, the opinion of the Secretary of the Treasury that the timely payment by the Association of interest on its Series ML Notes, and the repayment of principal at maturity, are proper functions for which the Association may borrow from the Treasury would be significant to prospective investors of the Series ML Notes and add substance to the warranty of the Association. Accordingly, it is assumed the Secretary of the Treasury would be willing to indicate in advance that loans will be made to the Association under the procedures provided for in subsection (d) of section 306, if there be any need therefor, to enable the Association to make timely payment of interest and principal with respect to its Series ML Notes.

Very truly yours,

(Signed) J. S. BAUGHMAN
President

Mr. J. S. BAUGHMAN
President
Federal National Mortgage Association
811 Vermont Avenue, N. W.
Washington 25, D. C.

Dear Mr. Baughman:

You have recently inquired whether the Secretary of the Treasury is of the opinion that the timely payment of interest on the Association's Series ML Notes to be issued to the investing public under subsection (b) of section 306 of the Federal National Mortgage Association Charter Act, and the repayment of the principal thereof at maturity, constitute functions of the Association within the

meaning of the following provisions of the Charter Act. Subsection (d) of section 306 provides, in substance, that the Association may issue to the Secretary of the Treasury its obligations in an amount outstanding at any one time sufficient to enable the Association to carry out its "Management and Liquidating Functions" under section 306, and further prescribes that the Secretary of the Treasury is authorized to purchase any obligations of the Association to be issued under section 306(d).

I am of the opinion that the timely payment of interest on its outstanding obligations, and the repayment of principal at maturity are unquestionably functions for which the Association may properly borrow from the Treasury. Accordingly, the Treasury will make loans to the Association under the procedures provided for in subsection (d) of section 306, if there be any need therefor to enable the Association to carry out its management and liquidating functions, including the timely payment by the Association of interest and principal with respect to its Series ML Notes.

Very truly yours,

(Signed) G. M. HUMPHREY
Secretary of the Treasury

BOARD OF DIRECTORS

The Charter Act prescribes that the Board of Directors of FNMA shall consist of five persons each of whom must be a Government officer or employee, to be appointed by the Housing and Home Finance Administrator. The Chairman of the Board, ex officio, is Albert M. Cole, Housing and Home Finance Administrator. The other members are J. S. Baughman, President of the Association; R. N. Reid, Vice President and General Counsel of the Association; L. E. Williams, Assistant Administrator, Housing and Home Finance Agency; and B. T. Fitzpatrick, General Counsel, Housing and Home Finance Agency.

FINANCIAL STATEMENT

It will be observed from the attached statement of condition as of the opening of business on November 1, 1954, that the assets of FNMA held under separate accountability for the Management and Liquidating Functions consist almost entirely of mortgages either guaranteed by the Veterans Administration or insured by the Federal Housing Administration.

The FNMA is self supporting and receives no direct appropriation from the Government for the payment of its administrative or other expenses. Net income of the FNMA from organization through October 31, 1954, amounted to \$165 million. Net income for each of the last three fiscal years has been as follows:

1952	1953	1954
\$29 million	\$34 million	\$25 million

J. S. BAUGHMAN
President
Federal National Mortgage Association

FEDERAL NATIONAL MORTGAGE ASSOCIATION

Balance Sheet of Management and Liquidating Functions at Opening of Business November 1, 1954

ASSETS

Mortgages and related receivables:

Mortgages guaranteed by Veterans' Administration	\$1,615,516,898	
Mortgages insured by Federal Housing Administration	<u>752,092,970</u>	\$2,367,609,868
Direct mortgage loans transferred from RFC		1,454,015
Accrued interest receivable	\$ 9,027,487	
Other receivables arising from mortgages	<u>427,861</u>	9,455,348

Purchase money notes of Defense Homes Corporation

Purchase money notes of Defense Homes Corporation	\$ 41,175,951	
Less: Valuation reserve	<u>14,410,226</u>	26,765,725

Assets acquired through foreclosure and claims in process:

Property held pending transfer to—		
Veterans' Administration	\$ 715,933	
Federal Housing Administration	<u>6,203,246</u>	6,919,179
Property held for sale		25,138
Claims in process against—		
Veterans' Administration	\$ 914,836	
Federal Housing Administration	<u>5,918,259</u>	6,833,095

Other assets:

Cash	\$ 2,763,080	
Miscellaneous assets	1,527,942	
Furniture and equipment, less accumulated depreciation ...	<u>153,929</u>	4,444,951
		<u>\$2,423,507,319</u>

LIABILITIES

Accounts payable and accrued liabilities		\$ 1,220,672
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Trust and deposit liabilities:

Mortgagors' deposits for taxes, insurance, etc. ^a	\$ 6,951,882	
Other trust and deposit liabilities	<u>2,240,117</u>	9,191,999
		\$ 10,412,671

INVESTMENT OF UNITED STATES GOVERNMENT

Payables to United States Treasury:

Notes payable	\$2,397,713,477	
Accrued interest payable	<u>15,381,171</u>	2,413,094,648
		<u>\$2,423,507,319</u>

^a Includes only that portion of such deposits held in the general funds of the Association. In addition, the Association is responsible for the payment by servicing institutions of taxes and insurance (out of funds received from mortgagors and held in escrow for that purpose) in the amount of \$32,168,667 at the opening of business on November 1, 1954.

At the opening of business on November 1, 1954, the Association was committed to purchase VA guaranteed and FHA insured mortgages aggregating \$602,665,819, under contracts previously executed, upon delivery of eligible mortgages.