INTERVIEWEE: Raymond H. Lapin

INTERVIEWER: David G. McComb

DATE: November 21, 1968

M: To identify this tape, I should say that this is an interview with Raymond H. Lapin, President of Federal National Mortgage Association--affectionately known as "Fanny May." The date is November 21, 1968, and the time is 3:35 in the afternoon. We are in his office in the new Housing and Urban Development Building in Washington, D.C.

Mr. Lapin, can you tell me something about your background, where you were born, when?

L: I'm from California, and I was born there--a native son, born in Inglewood, California, which is where the L. A. International Airport is now. I spent most of my life in San Francisco.

M: Where did you go to college?

L: Oh, my undergraduate work was at the University of California at Berkeley in the days when people used to shave.

M: You and I are old rivals. I have a degree from Stanford, the Stanford Business School, so we have an inborn enmity between us. When did you graduate from college?

L: 1942.

M: Did you go into the Army then?

L: Yes. As a matter of fact, I went into the Army before I graduated, but they gave me my degree. I went in as a private in the U. S. Army.

M: What was your degree in--what field?

L: Bachelor of Science degree in Business Administration--the College of Business Administration.

M: And then you're in the Army what--for the duration of the war?

L: Yes, I was there until early '46.

M: And then what did you do when you got out?

L: Oh, I worked for a couple of corporations. I had studied labor in college--labor economics, and the Army picked this up and toward the end of the war, they had made me a labor relations expert--so-called expert, worked on strikes; and some well known figures were in that work. Justice Brennan was one of my bosses, Arthur Krim, who was a friend of the President's, worked in this sort of thing, I remember--a few others. And then I stayed in that work--labor relations--for a couple of years after I got out of the Army, and then decided I didn't want to make a career out of it.

Then in 1950 I went to work for the Federal Reserve Bank of Chicago. I was administrative head of the research department and after about a year there my boss was George Mitchell who is now on the Board of Governors appointed by President Kennedy--he had been on leave when I first came--and Adlai Stevenson's when he was governor, Director of Finance and Chief Economist and then he came back. I worked there until I went back to California in 1954. I opened a one-man mortgage brokerage firm and spent a year--

M: This was the Bankers Mortgage Company?

L: Yes. The Bankers Mortgage Company. I had a brokerage firm in '54 and then in late '55, I incorporated and started a full-fledge mortgage banking firm. While I was in Chicago I went to school at night and got a master's degree at the University of Chicago in business administration, finance emphasis, graduated from there in 1954. It took me about three years at night.

M: So you immediately applied this knowledge in a business of your own?

L: Yes. I think the University of Chicago work, as well as my experience in the Federal Reserve Bank was quite helpful in developing a mortgage banking business, as this kind of business evolved in the '50's and became an interest rate business rather than a real estate business. And the business grew pretty well--

M: You set this up in Los Angeles?

L: No, San Francisco. The main office was in San Francisco, and I had nine branches around the state and also in Nevada--Reno and Las Vegas. It grew pretty well. We became one of the ten largest mortgage banking firms in the country in less than ten years, and our rate of growth was easily the fastest in the United States. No other company grew from scratch nearly as rapidly as this company did.

M: Granting your own talent in this, were there economic factors in California to help your growth?

L: Yes. I've been given a lot of credit for showing the foresight to go back to this area that was growing so rapidly, both rapid growing and a stable economy; as if it were really genius on my part. Actually I wanted to return to where my family and friends were. In fact I had returned before I had decided what business to go into, so all the credit I've been getting for having that much foresight is inaccurate.

M: But California was booming at the time.

L: Yes.

M: And you rode right along with it.

L: Yes, so was Texas, you know, and other places. The boom was not only there, the same thing was being done in Texas, you know, mortgage banking firms in Dallas and Houston, for example, have done remarkably well. I don't think

California has really been any more an opportunity area than Texas.

M: Then in 1964, is this when you merged your company?

L: 1964, we merged into Transamerica Corporation.

M: And then did you remain there as an officer?

L: I remained as president and chief executive officer until 1966. They had taken over pretty well by then, and I left to do some work for the State of California. For a few months my title was Commissioner of Economic Development and Chief Economic Advisor to the Governor. I worked for Pat Brown in the last several months of his period as Governor.

M: Had you been involved any in politics?

L: Oh, yes. And in community affairs. I've been a Democrat all my life and active in Democratic party activities; I was an active Young Democrat many years ago; and I've been active on-and-off ever since.

M: Were you active in California state politics?

L: Yes.

M: For the Democratic party?

L: Yes.

M: Did you participate then in the campaigns of 1960 and '64?

L: Yes, I was an alternate delegate in 1964 at the convention in Atlantic City. I've been active in fund-raising, not formally active--I haven't held an office such as northern California chairman, but I worked closely with these people and most of the California party leaders--northern California party leaders are close friends of mine, working with them over many years. Of course they all split up you know, and so I have very good friends this year who were in the Humphrey camp, but I had just as many friends in the McCarthy camp. When Senator Kennedy was alive, all of his leaders were my

L: That's what I heard too. I assume that's the fact; I don't really know. The first months of the Reagan campaign were very confusing; they had so many people in Sacramento, you know, inexperienced people, and there was a great deal of confusion. The transition was not a smooth one like it looks as if this one is going to be from President Johnson to Nixon. It looks like it will be a much smoother, much more sophisticated thing than we had in California. It was a mess. Neither side was helping the other.

M: That's what I was getting ready to ask you, the cause of it. That was due to the animosity between the two sides? Dislike for one another?

L: Oh, I think it's basically that there isn't the basic need for statesmanship at the state level; they can afford to not help each other without things going bad. But when you get to working at the level of having to do with our negotiations in Viet Nam or the impact of our monetary and fiscal policies and interest rates and our whole money structure of the country--it affects many other countries and so on. I think people at this level feel so much more of a sense of responsibility and are much more mature. I'd like to give those fellows at the state level credit and at least think that if they were at the federal level, they would be a lot more mature and would feel the responsibility of Federal office. Just take the one thing--there are a lot of lives at stake in everything they do, and I think this weighs very heavily and there's responsbility on a lot of people, and they don't indulge in pettiness like they do at state level.

M: Do you have any comment about actors going into politics?

L: Yes, I think being an actor, particularly in television, is a great help to the opportunity to be elected. I don't think it helps a damn bit in performance in office.

M: But in projecting an image and the use of television, that sort of thing?

L: Well, I think the facility that these people have when they have so much experience in front of a camera enables them to not have to do as good a job as they should; they don't have to work as hard because they can gloss over things much more easily.

M: Was this a factor in the campaign with Reagan and Brown?

L: It was a factor, yes. I don't think it was the only factor though that led to the defeat of Governor Brown.

M: What else was wrong then?

L: People were very fed up with taxes. I even heard from a number of people that they wanted Pat Brown to be defeated because their federal income taxes were much too high. And when you say, "Well, that's federal," they'd say, "Well, they're all the same, they all come under the same office and the same camp" you know, just a feeling people had--fed up with taxes. And a lot of people were fed up on racial problems; there was a backlash. People were concerned about--and I think they were very wrong in this--many people in the great suburbias of California which I helped finance, helped bring about--a lot of people there somehow believed that helping minorities was somehow going to deprive them of having a constant increase in the value of their property, things like that. A lot of misinformation, a lot of prejudice, a lot of reaction to progress to bring about equal opportunity--I think that worked against Pat Brown.

Pierre Salinger had the same experience two years before. George Murphy didn't win, rather,--Salinger lost because people in California wanted a change. The same thing happened to Pat Brown with Reagan; people wanted a change. And it was something that Hubert Humphrey was trying to overcome too. I don't know just why there's so much dissatisfaction; I think it's because almost everybody's working and making a better living than they've ever made before, and they have the time to indulge themselves. People probably would be more satisfied if they didn't have it so good.

M: Is California politics as complex as it appears to the outsider?

L: It's as disorganized; it's complex in that it's hard to form patterns, and it's completely unpredictable.

M: Is this due to the nature of the population?

L: That has a lot to do with it, yes. The population is still in a lot of ways unformed, but there are other things too that are different about California. There's no highly organized situation where there are rewards--jobs like there are in some areas. There aren't the incentives that you might find in some places like, say, Chicago, other parts of the country too--large eastern cities built up over the years, organizations; because there are rewards from politics. You have relatively very little of this in California, and the old cross-filing system I think kept things pretty loose too. There are quite a few factors that make California disorganized, unpredictable.

M: So a man like Reagan who can project a good television image has a good chance of winning something like that?

L: Yes.

M: Then you were with Brown, you say, until 1966, is that right?

L: No. I was with him until early '67. I was with the state until early '67.

M: Right. And then did you move from that position to where you are now?

L: Yes. Well, there was a few months' gap in there.

M: Why were you selected to this position as president of Fanny Mae?

L: Well, Stanley Baughman had been the president of Fanny May for almost twenty years and was reaching seventy and retiring. And the National Association of Home Builders askedmme if I might be interested in the job, and I started thinking about it then. And a number of other organizations and individuals thought it would be a good idea if I'd take the job. I felt that there was much to be done to improve Fanny May, and there was quite a lack of knowledge about how the mortgage market operates in Washington. I came to Washington on probably half-a-dozen occasions in 1966 during the credit crunch and talked with top government officials, and I had a good entree to them, but I could see that most of them didn't know anything about the situation--they were completely uninformed because they hadn't worked in the business. And they were going by what others told them or by data, most of which was usually several months old, and we had a sort of blind-leading-the-blind situation. So I felt I would really be able to help make a better mortgage market so we didn't repeat what happened during the '66 credit crunch which hurt some parts of the country economically more than others. California was very much hurt by it, and the home building industry was cut almost in half. Many builders out of business, went broke because of the credit problems. Some of these problems were caused by federal reserve actions and by action or inaction by the administration. But there was a lack of understanding that I think was because the situation had not arisen before in the post-war era, and because people in Washington--so many people didn't understand how serious it was.

M: Now, that crisis in 1966 laid a basis for a change in Fanny May, did it not?

L: Right. Fanny May did not do the job in '66. Fanny May did by far the best job it ever did in '66, but it ran out of resources. When it was really needed, it didn't have the resources to do the job, so it had to stop. For example, it bought several billion dollars of loans, much more than it ever had before in a one-year period; but in order to conserve its financial resources, Fanny May put a $15,000 loan ceiling on its purchases. Well, this cut off all new construction financed by Fanny May in California and in many other places. Some parts of the country were able to get along with a $15,000 ceiling, but it meant that Fanny May was completely out of business in California on new construction, and almost out of business on other loans too, but not entirely. A $15,000 ceiling meant one thing in California, and another thing, say, in Louisiana--a much different thing in Louisiana. It was a very inequitable rule. And as Commissioner of Economic Development, I'm not sure this was one of the basic responsibilities of that job, but I came to Washington in late '66 and was able to get that $15,000 ceiling changed--taken off. The action took place within two or three days after a trip I made to Washington with several industry leaders and Congressmen--Congressman Hanna and Congressman Tom Rees; and they were led by Congressman Chet Holifield--these three went with us to meet the President of Fanny May and the head of FHA, and we were able to get them to take the ceiling off.

M: Did this relieve the conditions in California?

L: Yes, things started to improve then.

M: What did it do to the financial resources of Fanny May?

L: Well, Congressman Hanna had gotten a change in Fanny May's financial structure; they had had a ten-to-one debt to equity ratio, and he got a law passed making it fifteen-to-one which relieved the situation. So the resources were improved somewhat, but still it kept on the $15,000 maximum mortgage amount. Among the changes that I've made since I've been here is to get that taken off entirely, and we have a much different system.

M: So you have no ceiling at all on debt to equity.

L: Well, any given time we have a ceiling, but it can be changed to meet the needs.

M: Can you as president make this change?

L: No. This is part of what we had done in the Housing Act of 1968. The Secretary of HUD retains the power to set the debt to equity ratio. As soon as this law was passed, we asked him to change to twenty-to-one and he did. And if we wanted to change it to something else, I imagine he would. The intent of the law is that the ceiling be something that's financially practical, but the ceiling would really be that which the investment community--the experts who have to do with selling our securities say should be the ceiling. Because if we were to stretch this debt to equity ratio beyond good sense, it would be reflected in the price we pay to borrow money. The investment bankers are able to tell us what the ceiling should be, and it's a much more sensible way than having Congress set an artificial ceiling like the old ten-to-one which was completely ridiculous. Ten-to-one is probably far out for some kinds of business, but for an organization that puts all its money into FHA and VA loans, it's silly. People in Washington don't always think of things like that. But that debt to equity ratio should relate to the degree of risk in what you do with your debt--how you invest the money.

M: Maybe I'd better back up a little bit and get you appointed here. Your name was put into the hopper--then how were you informed of the appointment?

L: Oh, Secretary Weaver telephoned me and said I had been appointed.

M: And how soon did you have to come to work?

L: Oh, immediately. I was in the hospital with pneumonia when I was asked to come back here by the next day. And I remember saying, "I can't come back the next day." The call came from the White House when I came to work--this was after Secretary Weaver had said I had been appointed. Said, "Come back tomorrow, Mr. Watson wants to talk to you." I said, "I can't." Somebody said, "Well, this is the White House." I said, "I'm having pneumonia today." So I took a few more days and then I came back.

M: Did you have any contact with the President during this period?

L: No. I saw Marvin Watson, and he said, "Come back any time. Anything we can do to help you," this was because--When I got to see Secretary Weaver then, I don't think he felt that I should be dealing directly--Fanny May was under the Secretary at that time--I don't think what Mr. Watson and Mr. Weaver said were consistent.

M: Weaver contacted you first?

L: Yes. I had had a series of conversations with Secretary Weaver before I came, because it had been felt that--they had decided I was the man for the job and they were worried by my owning a lot of stock in one company and felt I should sell stock; and I felt if it were put in an honest blind trust where the trust could divest of it in a logical way, that would be fine with me. I had no control over my assets that way, but it was believed by somebody back here that I should actually sell a lot of my stock; it was a bad time to sell it and I was advised not to sell it, but they insisted. So I sold. I sold at $43 and it's now $90, and it has cost me well over a million and a half dollars. I think the divestitive was completely unnecessary. We went over that a few times before I could come back. There's such a fear that people might somehow benefit from a government job that these things are done; I think it's a very bad system, and it should be improved. I hope people speak up about it, because I--

M: Well, in your case, it was a--

L: My stock was in one corporation--Transamerica Corporation--that had bought my mortgage company; but my mortgage company was one-quarter of 1 percent of Transamerica. Besides there's nothing I could do in Fanny Mae to help them at all, but this seemed to--you know, the ears here were completely deaf, and they just seemed to think I had to make this fine gesture and sell a lot of stock and show my worth or sincerity, I guess.

M: I would think that would make you question whether you should take such a job or not? You have to divest yourself--

L: No, I'm not sorry I did it. I did think it was unnecessary, but I would rather have had this done and have had the job and make these changes--have the opportunity to be part of the Johnson Administration and make these changes which I think were very valuable for the future. If I had to spend a million and a half dollars to get the job this way, I would do it. But it was unnecessary. There's no logic to it. But I'm not sorry I did it. In other words, I certainly wouldn't say that I wished I had not taken the job to save a million and a half dollars; I don't think that at all. I think it's a great honor to be part of the Administration, have a job like this. I think for people who can afford it even if it takes a million and a half dollars, they should do it--I mean that, so I don't regret it.

M: Then you came to Washington, found a place to live, started to work. You were aware already of some of the problems of Fanny May, having worked with it?

L: Yes.

M: For the record, I suppose something ought to be said about Fanny May in elementary terms as to what its purpose is and the condition it was in when you took over.

L: Well, the purpose of Fanny May is to provide liquidity to the secondary mortgage market by buying FHA and VA loans when private investors are not.

M: You're restricted strictly to VA and FHA?

L: Yes, and Farmers Home Administration loans, although we never bought any because they never offered us any. They don't need us apparently. The department was very well organized, stabilized. And the people are remarkably efficient in Fanny May compared with many other parts of government.

M: Let me ask you this other elementary question. The purpose of Fanny May is to support a secondary mortgage market, buy FHA and VA loans when nobody else is buying them.

L: Well, yes, that's saying it--I said it a little too strong. We buy all the time, they're constantly in the market, but we're needed the most when other people are not buying. So the figures vary from a small amount to a very large amount, you see, over different parts of the money cycle.

M: Where do you get your money to do this with?

L: I should say before I answer that there were three major functions of the old Fanny May, and this secondary market operation was one of the three. The money was obtained primarily by borrowing in the capital markets atmmarket rates, selling debentures and discount notes, which is really short term commercial paper; but also having gotten a small part of the funds from the United States Treasury where they borrowed for short term periods, and the Treasury also provided some of the capital, being the sole owner of Fanny May's preferred stock--common stock at that time was owned by the public.

The second function of Fanny May was a special assistance operation which comprises the low and moderate income FHA program. Fanny May financed many of these mortgages with funds borrowed from the Treasury.

The third function was a marketing and liquidating function that has to do with maintaining older portfolios, primarily--government-owned mortgages.

M: Okay. You buy up these VA, FHA backed loans from money that you get from private sources and from public and from your own capital resources that were there originally. Then what do you do with these? Can you sell these mortgages that you've bought up?

L: In the past years mortgages would be sold, and that was the original idea--to buy them when we needed to provide liquidity and then sell them when there was an overabundance of savings, and that rarely happens. It happens only in a recession-type period when money is very loose and there aren't enough mortgages being generated to sop up the savings that are not being put to use. So Fanny May did perform an economic function of providing mortgages for an overabundant money market during recession type periods. This has only happened three times--three short periods in the post-war era.

M: And the purpose of all this is to stabilize or to keep relatively stable the mortgage market?

L: Right.

M: Does Fanny May make a profit?

L: Yes. Here's a chart that will show you these sales. Fanny May has made a profit continuously and has paid the equivalent of corporate income tax since it has been in business.

M: It's really not officially a tax though, is it?

L: No, it was the equivalent, but it is not officially a tax. I'll talk about that when I get to the change. But the dollars were the same.

M: You mean the dollar amount would be the same as a corporate income tax?

L: Right.

M: Now, you're in the position of president. You've been through this 1966 dry spell; so what is your first task? What reforms do you bring in?

L: Well, I didn't think that the system that Fanny May was using was the most effective for the secondary market operation; that is, buying loans on an over-the-counter basis--loan by loan. So we developed this new free market system of weekly auctions, and we did this with department support and certainly very much White House support. I'm sure that President Johnson to the extent he was informed what was going on, was very much in favor of this. He knew people in the home building and related businesses. And so we changed to a commitment system, providing blanket commitments rather than purchasing loan-by-loan. Most of these people that financed mortgages needed commitments; they need to know that they have a price that they can sell mortgages for some time in the future. They have the option of a three-months, or a six-months, or twelve-months commitment. We recently changed the twelve months to either twelve or fifteen or eighteen months, so we have three, six, twelve, fifteen, eighteen months commitments, which enables mortgage bankers and banks to have a stabilized price against these commitments.

And for new construction, the twelve-months, fifteen, eighteen-months, they can issue commitments to builders who need to know that for that period ahead they've got a fixed price. They know exactly what their selling price is. It's then set for them, so they don't have to worry about changes in the money market, and they can then budget that aspect of their project. They know what their financing will cost by having these commitments.

But we decided also to change from having us just arbitrarily set prices; our mandate says that Fanny May will have prices within a range of the market, but previously we set those prices arbitrarily at a given time. And every once in awhile we changed them when the market changed, but it was sort of a sticky thing to get them changed.

M: Now, when you say a price, exactly what are you talking about?

L: Well, an FHA or a VA mortgage has a face interest rate, so when interest rates or the return on investments or yields change you go to a premium or to a discount; so most of the time you have a discount. So on a 6-3/4 percent fixed loan, i.e., with a face rate of 6-3/4, if an investor buys a loan at par at a hundred, he gets exactly 6.75, but if he buys it at ninety-eight, or with a two point discount, he gets a yield or return higher than 6.75, at about 7%.

M: These commitments then that you sell would carry a price like what?

L: Prices vary up to ten or twelve points. In a normal market you may have prices of two, three, four points discount; in other words, ninety eight, ninety seven, ninety six.

M: Do you measure the price in terms of the discount?

L: Yes.

M: Off of par value?

L: Yes. But in a real tight money period when you don't change the face rate, you may get prices down as much as twelve points discount, which would be eighty-eight. And usually for new construction when you get beyond about four or five points, the builder is starting to lose money, because he has to pay the discount. The home owner pays the face rate, but the builder has to pay the points. I mean, if he is selling his mortgages at eighty-eight or ninety, he's going to probably go broke. And a lot of them did in 1966. It was a very bad system.

M: Well, then in your weekly auction, you're allowing a future--

L: By buying these commitments, they know what prices they have for that period into the future, so it tends to stabilize the market.

M: So they can have a sounder planning policy?

L: Yes.

M: This would affect their construction business especially.

L: It affects the mortgage banking and the building and the real estate business.

M: All down the line.

L: Right.

M: Does it help the home buyer?

L: Oh yes. It helps the home buyer because it makes FHA financing available to them. It enables a builder to build more houses, say, there being a much more stable position with respect to this one variable in his business, so he can deal on better terms with the home owner.

The price itself has to be a reflection however of a level of interest rates, so this commitment system doesn't actually make prices higher or lower; making the prices higher would help the home owner--that's why we work hard on such things as a tax increase when it's needed, proper fiscal policy, and proper effective monetary policy to try to keep interest rates stable. We can't in Fanny May change that; we can make these structural changes such as the commitment system.

The other part of the free market system that is significant is that instead of our arbitrarily setting the price, as I said, which was the way we operated before, therefore getting a flood of mortgages if our prices were the most attractive, which resulted in our using up all our dollar resources, we changed to a system where instead of controlling the price and having no control over the dollars we had to put up, by having the weekly auctions, we have complete control over the volume by announcing the dollars and let the market set the price. These prices that have come about from the auction--we've had six months experience on it now--have shown that it is a very sensitive and consistent statistical series. Our prices were also very sensitive to the recent tax increase. Before the increase our prices were deteriorating each week. However, as soon as the increase went into effect our prices improved. Now that the bond market has changed our prices are dropping again. We're in a bad situation right now, and this auction is showing it. We could show you a chart on this.

M: How does this auction work? Do the buyers of commitments know that this auction is going to take place every Tuesday, or something like that, and then they send in bids? How do the mechanics of this auction work?

L: Well, we announce the size of the auction. Like we announce $60,000,000 for next week; we change the volume as you can see from those columns. And we get in offerings that are perhaps three times that; it varies from two and a half to four times of that, say. And then they say what volume they want and whether they want the ninety day or the six months or the one year or fifteen months or eighteen months, and the fees are different for these different periods. But the three major areas--the three months, six months, and twelve months don't compete with each other. They are separate auctions. They state the price that they're willing to accept a commitment from us. So if we have announced a $60,000,000 auction, let's say, and we get $120,000,000 of offerings, that means we can take half of them from each of our three major sections the three months, six months, and twelve months. We take 50 percent of each of those groups, starting from the lowest price and work up. And that determines the prices of that particular auction.

People can elect to a non-competitive bid, but they can only do that up to a maximum of $50,000 per week. This is for smaller companies. Then we just use the average of who won, so that keeps them in business. But a company may go up to a million and a half a week.

M: But you do take steps to protect the small independents?

L: Yes, the small seller of loans, that is, the small mortgage banker is well protected by the non-competitive bid. He doesn't have to bid; anyone can elect to take non-competitive bids instead of bidding in a price, in which there is the possibility of winning or losing.

owned, we're completely free of that illogical or paradoxical situation.

M: Now, is this idea to give your weekly auction the freedom that it needed--did this lead into the change in Fanny May, or was there some other basis for this?

L: Well, when Fanny May was first set up in 1954 in the form that it had had up until this year, the Congress said that Fanny May would become completely privately owned as soon as it was able to. It might have been done in previous years, but there wasn't any real impetus to it. But the credit crunch of '66, when they ran out of money, I,think showed that something had to be changed. If we were going to have another credit crunch, we had to have more resources. And we couldn't remain in the budget and be able to have the effectiveness when we were needed the most. We had to not be like a fire department that had plenty of water except when there was a real conflagration.

The Budget Concepts Commission report gave impetus to this, because it spelled out exactly what were the conditions for a federal agency being in or out of the budget. And it also made it quite clear that in the attempt to encompass as much as possible in federal spending, it made all of Fanny May's purchases part of federal spending. So we could see this was illogical. So I'd say the Budget Concepts Commission report, which was a very well done report, had to do with it quite a bit.

Incidentally, the President showed great courage I think in accepting the Budget Concepts Commission recommendations; this was certainly not politically advantageous. And I assume that somebody will be interviewed on all of this, because he certainly was not motivated by any political

M: You say the President gave you rather enthusiastic support for this?

L: Yes. Not directly. The President himself--I haven't heard him speak about it, but I can tell from people in the White House such as Joe Califano and others that this was very well received.

M: And they understood what you were doing in--?

L: Joe Califano certainly has. Joe Califano has been very helpful to us. Another man who has been very helpful to us and has had a lot to do with the success of our change in status has been Charlie Zwick. He has been excellent.

M: As Director of the Bureau of the Budget?

L: Yes. Zwick I think has done a very good job and should get some real credit for our development of the privately owned Fanny May.

M: In your operation, the setting of the level of commitments and so forth, do you consult with the Treasury or with the Federal Reserve System or with the Bureau of the Budget or any of these other agencies dealing with fiscal matters?

L: No.

M: This is an independent operation?

L: We used to when we were under an administered price basis; part of the reason it took so long to get price changes is that we had to have so many meetings to have changes. But, you know, we did have good cooperation. But we don't now because it's an automatic program; it runs itself. The market determines these things. We do determine the volume from week to week, but even that is the result of the total offerings of the previous week.

But the auction itself couldn't have worked if we hadn't made the change in status. I think we should finish talking about the free market auction system before I tell you that. But we couldn't get the dollars for the auction if we had not made the change in status.

M: Do you want to say anything more about this weekly auction?

L: I think I've covered it.

M: Why don't we go into the changing of status then, which is the 1968 enactment? How did that come about?

L: Let me say that one part that affects the auction, and then I'll get into what it's all about.

One of the things it did was enable us to not have the constraints of the budget. If it weren't for our change in status, our total commitments into mortgages would have to be considered as federal spending, and for this year we were budgeted $1,000,000,000 so the maximum sized auction would be $20,000,000 a week if we stretched it out. We've gone up in our weekly auction to where we're on an annual rate of $5,000,000,000; and we could go higher if we wanted to. But being in the budget, we were restricted. What's particularly bad about being a government agency and having our total investment in mortgages being considered federal spending the way it was if we hadn't made this change, is that we're needed the most when money is very tight. At such times the mortgage market can't compete. That's when Fanny May was needed to come in and commit to buy loans. Well, if all of that buying of loans is with budgeted dollars, we're spending dollars and increasing the deficit at just the time when the Administration wants to do the opposite; the time the pressures are on the greatest to not increase the deficit is when you're in a real boom. Now that real boom period is exactly when we're needed the most; that's when money gets tight. So it was a reverse situation. In getting out of the budget by becoming privately considerations in accepting their report, and he accepted their report almost 100 percent. I'm not sure every President would do this.

M: Where was the political danger in that--in the acceptance of that report?

L: Well, I wouldn't call it danger exactly, but it brings in many more types of activities into the budget that makes spending appear to be a lot higher than otherwise. The figure jumped way up with the change. Nobody understands what the advantages are. They can just see that it's a worse looking total figure. You can explain and explain and people don't comprehend.

Also, one other issue in this was he agreed to have the participation certificates be changed to where there wasn't the budgetary advantage in the way they'd be treated. This was a highly controversial subject, and he went along with the very conservative view on that -- a view which a lot of people didn't agree with. And there are other parts of it too. I think it all made for a more honest budget reporting, but it didn't make the incumbent President look any better to make the change in this period. It's sort of like why nobody is in favor of tax increases; they really know that you need them, but politically they're not very popular--the same kind of thing.

M: Was it out of this that came the idea of making Fanny May independent?

L: No. We had the idea way in advance of this, but it did give us the advantage to get more help to get it done.

M: Then a bill had to be written to bring this about?

L: We wrote the legislation here in Fanny May that made it possible for us to become privately owned. We had to find a way to pay off the Treasury preferred stock, which we did by issuing a capital debenture of $250,000,000.

This is something that has never been done in government before--a capital debenture. This is done a lot by commercial banks; it has never been done by a government agency. A lot of people said that they didn't think it could be done or should be done; they didn't think we could do it very quickly and we had it done months before anyone thought we could. You see, the Housing Act passed August 1st, and our private status was effective September 1. But we were out of the budget by September 30, which was months before anyone thought we could do it.

Now we have been operating at a rate of buying mortgages at $3,000,000,000 a year; that's how much a month? $250,000,000--you know, over-simplifying a little bit, but the sooner we did it the better, you see, because the more we were able to contribute toward the reduction of spending. Everybody was pretty happy we were able to move so fast. It took a lot of working Saturdays and Sundays to do this.

M: At this point in time then, you became independent of government financing?

L: No. We are still not independent of government financing bytthis. We coordinate all of our borrowings with the Treasury; we're still a government instrumentality. By far our major purpose is the public interest.

M: Right. This point might be cleared up. Even though you are in effect owned privately, your stock and so forth, you're still operating in the public interest.

L: That's right. We still operate for the purpose of providing liquidity into the mortgage market which we can now do much more effectively than we could as part of the Administration. But there are safeguards to see that our purpose remains that. Even though we will have a board of directors, two-thirds of whom will be elected by the stockholders so our direction will come from this board, but they have to work within a framework of this public purpose and a heavy influence, so this board will come from people related to the mortgage industry. We've put safeguards into the law to see that that will happen. And the Secretary of HUD has a certain degree of regulatory power over the private Fanny May to see that the public purpose remains paramount.

M: So there's no loss in that area?

L: No. There is an increase in effectiveness with respect to government dollars, and no loss with respect to our public purpose.

M: Then what is the purpose of the so-called Ginny Mae? (GNMA)

L: Well, you'll recall I said we had three auctions--the secondary market, the special assistance, and the liquidating and marketing functions--marketing and liquidating function remain in government and become a new corporation called Government National Mortgage Association or Ginny Mae.

M: So this is a split in your function?

L: Yes.

M: And they will be setting up a new organization?

L: Yes, except it's a mighty little one. We decided since we're taking an entity and cutting it into two parts that we didn't want the two parts simply because cutting it in two would be a total larger than the one that existed before, so Ginny Mae will have just a skeleton crew of top officers, but its work will be done by Fanny May by contract. We've been doing this for all of these years and will continue to do it by contract; that way we keep costs to a minimum as a result of the change. The law says that Fanny May and Ginny Mae can do work for each other by contracts, but Fanny May will do most of the work of Ginny Mae by contract.

The private corporation will do the work of the government agency.

M: In this new arrangement you will still be part of HUD--is that correct?

L: No. There remains regulation by the Secretary of HUD over the privately owned Fanny May, but we're not part of it. They have regulation over us such as the federal reserve has over members banks, or the Federal Home Bank Board has over federal home loan banks, and therefore over savings and loans--that sort of relationship.

M: Will you still maintain your offices in the HUD Building?

L: We're not sure whether we will or not. We may or may not. I think we will wait and see what the new Secretary thinks about it. We work closely with HUD of course, but we also work closely with the Treasury and Council of Economic Advisors, the Budget Bureau; so we could find a case for having proximity here or to that area too. We deal with them as much as we deal with people here, it seems.

M: But your officers in Fanny May will be selected by your board of directors?

L: Yes. We have an interim period of anywhere from two to five years during which I have been appointed by the President for this term. So I'm not submitting a resignation to the new President, because I don't serve at the pleasure of the President--I serve for a term, but it's an undefined term somewhere between two and five years.

M: How are you going to define that? Are you the one to define that?

L: No. The law has defined it; the law says that as soon as one-third of our outstanding stock is owned by mortgage market related people and its primarily mortgage banking, but also other related industries, then we can go to the final status. When we go to the final status instead of a nine-man board, we'll have a fifteen-man board--ten of whom are appointed by the stockholders, five by the President of the United States, and that board will elect the president and chief executive officer.

M: Whenever that shall take place.

L: Yes. But it will be no later than May of 1973.

M: Do you think that the reforms that have been brought about in Fanny May will be permanent?

L: Yes, of course. They're so entrenched I don't see how they could possibly not be.

M: Do you--

L: All of our employees, you know we have a thousand and some employees, and most of them will be out of Civil Service for just--we're in the midst of this now, you know. They're all becoming non-Civil Service employees with a private system of pay and fringe benefits and so on. They're all being asked if they want to stay in government or move over, and most of them are moving over to private status which is a big step for them. In other words, we're in the middle of this right now.

M: Now, is there anything more about this operation of Fanny May and your contribution that I should have asked you and I didn't?

L: Yes, I think there are a couple of things. As I said, Charlie Zwick has been very helpful to us and the people in the Budget Bureau; Joe Califano at the White House; the Treasury, Federal Reserve and so on. We've had complete support from top people throughout the Administration--setting up this new privately owned corporation which is a sort of experiment. We're a corporation with a public purpose, but we pay our own way completely. And we pay corporate income taxes. And we pay continuous dividends to our stockholders, and our stock has done very well. It was around 60 for some years, and it's around 165;

it's doing very well. It's the only government agency that exists with a common stock that's freely traded in the market. And this is the only government agency with a common stock that has just leaped upwards since the change to wholly private status. So there are a lot of people very happy with us, you know. Our earnings are pretty good. We'll pay our top officers salaries that are commensurate with private industry and finance rather than government, so we'll be more efficient. We're putting in a new EDP system that is going to save us several million dollars a year, three to four million dollars a year, which is pretty close to a 30 to 40 percent of our total administrative costs.

M: You're going to operate it like a private corporation then?

L: That's right, exactly.

M: Now, you're going to have to use Civil Service people?

L: Not at all. None of our people will remain Civil Service people. We do a lot of work for government by contract, but we're saving a lot of money, we'll have more efficiency--I should say we're going to, we're doing it right now. As I say, this is an experiment. We have a board of directors, two-thirds of whom will be elected by stockholders, who will run this corporation. It's a very interesting development in government. We're saving, as I said, $3,000,000,000 a year right now but if we were buying $5,000,000,000 a year in mortgages, we'd be saving $5,000,000,000 a year because of the peculiar way federal books are kept.

M: Have you caught any of the old criticism about government competition with private business?

L: Not at all. There hasn't been any criticism of this. The reason I'm emphasizing this now is that President Johnson is responsible and the people under him for bringing this about, and you don't hear much talk about this in a Democratic Administration. To a lot of people what we've accomplished sounds like a Republican Administration. But President Johnson very much wanted this privately owned Fanny May--I haven't talked to him, and I wouldn't mind talking with him about it some time. But I haven't.

M: But you know you have his support?

L: But I know we have his complete support. Well, he appointed me president of the new organization when it was set up -- (interruption)

M: You were talking about the support that you got from the President and his staff.

L: I think that as the years go by other entities of the Administration that are able to pay their own way will do the same thing that we've done, because it saves money to the taxpayers -- in our case, an enormous amount of money, billions. It helps bring about great efficiency, and it enables more freedom of operation. I don't think this is only true of ourselves -- I think this corporate form for government is just the beginning of a general movement. And I'm sure that there are other parts of government that are watching us very closely to see how well we're doing and if it works well, they'll want to do the same thing if they have an activity where they have enough income related to what they do.

M: There's a question that somewhat parallels this and bears on what has happened here. Would this have happened if President Johnson had not been caught in a budgetary squeeze because of the Viet Nam war? Is this a result of the war and the need for money in government, or would it have happened anyway?

L: I can't be sure, because I've only been in government myself a year and a few months.

M: But it's using private funds and resources for public purposes --

L: We used primarily private funds before; it took some initiative to make these changes and a great deal of cooperation. The need to do it was there anyway. But whether or not we could have had as much support if the need didn't have the degree that it had, I'm not sure. But I believe if President Johnson had a clear understanding of it, it certainly would have happened.

M: But can you get to President Johnson unless you have a certain degree of need?

L: I don't know; I have no way of telling.

M: But from your point of view, this was a logical, necessary, useful step, whether there had been a war or not?

L: Of, of course. Why should an organization that has a public purpose and gets all of its money from the private markets have all of that mortgage investment be considered federal spending when it isn't really? We borrow money in the market at market rates for the purpose of buying marketable mortgages; the old system didn't make a hell of a lot of sense. But all of the efficiences that derive from this are very important.

There are other things about it that I haven't mentioned that I should. You hear a lot of talk -- I heard a lot of talk from all candidates and would-be candidates -- Senator Percy and many others, Governor Rockefeller -- that we've got to finance housing with private means rather than government. We in the special assistance program finance most of the low and moderate income programs. I can now finance -- and we are right now financing most of them, not with special assistance money that we borrow from the Treasury, but in the private Fanny May. And we can make the few millions of dollars that we get from the Treasury for special assistance go much further by having Fanny Mae buy these mortgages from Ginny Mae and having them only pay the subsidized portion (the tandem plan). All of the things that all candidates were talking about they want in using private money rather than government money, we are doing right now

I don't understand why Mr. Humphrey at no time ever referred to this since it had been accomplished before his campaign. I tried to get this information to some of his staff so he'd know, but at no time was this ever mentioned by him. And the thin s that they're saying that they want to bring about, we have done. In President Johnson's Administration we've brought about this mechanism. We really have a bank. We're not--you know, we are named the Federal National Mortgage Association but we are a bank like all the other agencies--we're a bank that uses entirely private money, finances low and moderate income programs. We're not financing all of them all the time. We only want to finance them when we're needed. So if the life insurance industry says "We'll put in a billion dollars," we'd rather have them do it. But when we're needed, we can do it. We're going to back the new 236 and 235 programs; we're backing the rent supplement programs; and we're able to do all of this with private money. The only thing we can't do is provide subsidy money; that has to come out of the Treasury. But I think all of this money should come from either the private market or ourselves, which is still the private market, and have the Treasury only finance a subsidized portion. That way you keep federal spending down. Instead of having the Treasury finance the whole of mortgages which they had been doing, we have been doing that too. And it's too bad that Mr. Humphrey didn't know it. He could have talked about it I think. You know, this had been done in the Johnson-Humphrey Administration.

M: Well, the people in the other agencies, such as the FHA and the VA and the various mortgage bankers across the country and the HUD Secretary--these people know what you're doing. Maybe it's just the top echelon that--

L: Well, a candidate hasn't got time to know about anything when he's a candidate.

He's too busy just worrying about what time he has to get up the next morning, how many speeches he has that day, and how the polls are going and so on. He has got a big staff of people who are supposed to be expert in all areas. Where the hell these experts were for housing for Mr. Humphrey, I don't know! I never could find them. I tried several times.

M: You've got an education problem then to tell some of these people about--

L: It's too new. The people in the industry know; all of the home builders and mortgage bankers and commercial bankers and savings and loan people, the realtors, they all know all of this, but the general public doesn't. They don't know that in the Johnson Administration this major step--this isn't the only major step that has been taken that saves money, but this is one of the major steps that has been taken to save a lot of money, and to do something a lot better than it has ever been done before. I'm positive that we're part of a permanent major contribution to the federal government.

M: Do you have any other comments you wish to make?

L: Not about the privately owned Fanny May.

We have one other program that was in the Housing Act that I wanted to talk about--the new mortgage backed securities. The residential mortgages, whether it's FHA,VA, or conventional, is not really competitive--FHA and VA particularly because of the fixed rate. It's not competitive with other forms of debt, particularly when money is really tight; they don't get their share of the pie. And when money gets very tight, home financing is inordinately hurt. That's what happened in the '66 crunch. For years and years, there has been talk about how do we tap this huge new source of savings of the pension funds and retirement funds and so on. Well, in the 1968 Housing Act of the same title, Title VIII, that set up the private Fanny May, Congress approved the Administration's recommendation for the new mortgage backed security. And we're getting it into operation now. This is going to be handled by Ginny Mae -- administered by Ginny Mae -- where Ginny Mae will put the full faith and credit of the United States on these securities; Ginny Mae acts as the guaranteeing agency. And Fanny May is doing most of the work in getting it going, and we'll probably market the first of these because we can do it more efficiently because of our experience in marketing a lot of securities. We're handling now about $15 billion in outstanding securities, counting the PC's; and we're experienced in dealing with underwriters and doing all of this. We know how to accumulate mortgages, and we know how to secure them. We want to get it started, but then the private market can take ones and do this too. The law says that either Fanny May or private institutions can issue these new securities; if they get the approval of Ginny Mae, they can get this guarantee which has the full faith and credit of the United States which brings down the cost tremendously. This is a good function of government to issue guarantees to reduce risks to make some form of borrowing cheaper. In this case they'll bring down the cost of financing quite a bit and enable mortgage financing to get its share of the pie in times of very tight money, which has never happened before.

This means that we will have a more stable home building industry; we won't have these terrible ups and downs which has helped keep it in an inefficient stage compared with other industries. Housing in the past by some people has been considered a contracyclical form of industry, which meant that it could go real strong during recession and then it's supposed to stop completely when money is very tight -- when we are in a super boom. And by having these constant ups and downs, housing construction has remained inefficient, and the would-be home owner is the one being really hurt. So we think that we'll be able to do a great deal to smooth out these ups and downs by the mortgage backed security, by having a good steady flow of money into mortgages.

M: Whose idea was this incidentally?

L: Oh, it has really been kicking around for years, just like all these ideas; it's just that nobody ever really put it into practice until we came along and did it--put it into this Housing Act of 1968.

The home builders had a proposal that was similar; that is, the germ of the idea was similar. They had a certificate of beneficial interest approach. We've developed it quite a bit beyond that. By the way, we have it written with the government guarantee, with SEC exemption, and a whole lot of other things to make it work well. We worked it through quite a bit before we put it into the act, and we have a staff that can do these things--a pretty knowledgeable staff, lawyers, people who know the mortgage market and the securities market.

We think that both the free market system which creates an organized market with a price every week for our mortgages, with a real free market where the cost of mortgages is determined by market forces and the mortgage backed security which provides marketability to the mortgage market for the first time--we think both of these could also apply to the conventional loan, even though we're going to be doing them only with the FHA and VA loan for now. It can be applied to the conventional loan and do even that more effectively. That will take more legislation, and that will become a little more controversial, I suppose.

M: Well, I wish to thank you for the interview. It was kind of you to take the time.

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By Raymond H. Lapin

to the

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