REPORT BY THE

Comptroller General

OF THE UNITED STATES

105533

Examination Of Financial Statements Of The Federal Home Loan Bank Board And Related Agencies For The Years Ended December 31, 1978 And 1977

GGD 79 72

JUNE 21, 1979

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

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To the Board of Directors
Federal Home Loan Bank Board

We have examined the statements of financial condition of the Federal Home Loan Bank Board, the Federal home loan banks, the Federal Savings and Loan Insurance Corporation, and the Federal Home Loan Mortgage Corporation as of December 31, 1978 and 1977, and their related statements of income, expense, retained earnings and primary reserve, and changes in financial position for the years then ended. Our examination was made in accordance with the Comptroller General's standards for auditing financial transactions, accounts, and reports of governmental activities. To the extent possible, we used the work of internal auditors of the Board and FSLIC during our audit. Our examination included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously made a similar examination of the financial statements for the year ended December 31, 1976.

The Federal Home Loan Bank Board has shown a deferred credit—FHLBB cost of quarters—of $44,400,000 and $42,094,280 as of December 31, 1978 and 1977, respectively. (See sch. 1.) The deferred credit represents assessments to the 12 Federal home loan banks for the cost of the Bank Board's new building and land. This deferred credit is currently shown as a liability; however, there is no intention by the Bank Board to repay any portion of this assessment to the 12 banks. Accordingly, we believe that this and all future capital assessments should be classified as paid-in-capital, and the amounts above should be reclassified. The Bank Board agrees with the reclassification.

In our opinion, except for the reclassification of the deferred credit mentioned above, the accompanying financial statements (schs. 1 through 13) present fairly the financial position of the Board, banks, and Insurance and Mortgage Corporations at December 31, 1978 and 1977, and the results of their operations and the changes in their financial positions for the years then ended in conformity with generally accepted accounting principles applied on a consistent basis.

Elmer B. Staats
Comptroller General
of the United States

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FEDERAL HOME LOAN BANK BOARD

FINANCIAL STATEMENTS

DECEMBER 31, 1978 AND 1977

 SCHEDULE 1

FEDERAL HOME LOAN BANK BOARD

COMPARATIVE STATEMENT OF FINANCIAL CONDITION

AT DECEMBER 31, 1978 AND 1977

	1978	1977
ASSETS:		
Cash with U.S. Treasury (note 2)	$ 120,830	$ 965,713
Accounts receivable	8,404,184	9,121,762
Land and building (notes 1 and 3)	45,645,160	43,595,615
Furniture, fixtures, and equipment net (note 1)	4,238,196	3,885,246
Other	1,422,321	314,245
Total assets	$59,830,691	$57,882,581
LIABILITIES AND CAPITAL:		
Accounts payable and accrued liabilities	$ 2,716,302	$ 5,076,910
Employees accrued annual leave	2,648,297	2,178,807
Deferred credit--FHLBB cost of quarters (note 4)	44,400,000	42,094,280
Total liabilities	49,764,599	49,349,997
Capital, retained earnings	10,066,092	8,532,584
Total liabilities and capital	$59,830,691	$57,882,581

The accompanying notes are an integral part of this financial statement.

SCHEDULE 2

FEDERAL HOME LOAN BANK BOARD

COMPARATIVE STATEMENT OF INCOME, EXPENSES,

AND RETAINED EARNINGS FOR THE YEARS ENDED

DECEMBER 31, 1978 AND 1977

	1978	1977
INCOME:		
Fees from examinations of savings and loan institutions	$17,282,002	$15,951,570
Assessments:		
Federal Home Loan Banks	8,258,254	8,549,507
Federal Savings and Loan Insurance Corporation	21,527,595	20,755,996
Reimbursements for services performed	146,558	142,775
Miscellaneous	679,512	215,662
Total income	47,893,921	45,615,510
EXPENSES:		
Personnel compensation	31,056,845	27,622,647
Personnel benefits	3,075,048	2,720,442
Travel and transportation	5,167,867	4,997,594
Rent, communication, and utilities	3,015,909	3,090,414
Depreciation:		
Furniture, fixtures, and equipment	243,328	387,813
Building	600,000	-
Other services	2,104,656	3,190,281
Printing and reproduction	333,548	177,812
Supplies and materials	763,212	965,611
Total expenses	46,360,413	43,152,614
NET INCOME	1,533,508	2,462,896
RETAINED EARNINGS AT BEGINNING OF YEAR	8,532,584	6,069,688
RETAINED EARNINGS AT END OF YEAR	$10,066,092	$8,532,584

The accompanying notes are an integral part of this financial statement.

 SCHEDULE 3

FEDERAL HOME LOAN BANK BOARD

COMPARATIVE STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEARS ENDED DECEMBER 31, 1978 AND 1977

	1978	1977
FINANCIAL RESOURCES WERE PROVIDED FROM:		
Operations:		
Income:		
Examination fees and charges	$17,282,002	$15,951,570
Assessments:		
Federal Home Loan Banks	8,258,254	8,549,507
Federal Savings and Loan Insurance Corporation	21,527,595	20,755,996
Reimbursements for services performed for other agencies	146,558	142,775
Miscellaneous	679,512	215,662
	47,893,921	45,615,510
Less expense:		
Personnel compensation and benefits	34,131,893	30,343,089
Travel and transportation	5,167,867	4,997,594
Rent, communication, and utilities	3,015,909	3,090,414
Other services	2,104,656	3,190,281
Printing and reproduction	333,548	177,812
Supplies and materials	763,212	965,611
	45,517,085	42,754,801
Total resources provided by operations	2,376,836	2,850,709
Increase in:		
Deferred credit—FHLBB cost of quarters	2,305,720	10,800,000
Employees' accrued annual leave	469,490	190,075
Decrease/(increase) in:		
Furniture, fixtures, and equipment	(596,278)	(3,060,768)
Accounts receivable	717,578	(1,223,604)
Other assets	(1,108,076)	(314,245)
Total resources provided	$ 4,165,270	$ 9,242,167
FINANCIAL RESOURCES WERE APPLIED TO:		
Acquisition of land and building	$ 2,649,545	$11,832,722
Increase/(decrease) in cash	(844,883)	106,072
Decrease/(increase) in accounts payable and accrued liabilities	2,360,608	(2,698,627)
Total resources applied	$ 4,165,270	$ 9,242,167

The accompanying notes are an integral part of this financial statement.

FEDERAL HOME LOAN BANK BOARD
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 1978 AND 1977

1. Summary of significant accounting policies:
   a. Furniture, fixtures, and equipment--These assets are at cost less accumulated depreciation of $1,583,902 and $1,194,231 at December 31, 1978 and 1977, respectively. Depreciation is computed on straight-line method over the estimated useful lives of the property.
   b. Building--This asset is at cost less accumulated depreciation of $600,000 at December 31, 1978, the first year of depreciation on the building.

2. An additional $392,881 is available in a separate fund provided by appropriations pursuant to the provisions of the Emergency Home Finance Act of 1970. Use of such funds is for the purpose of adjusting the effective interest charged by the Federal Home Loan Banks on short and long term borrowing in order to promote an orderly flow of funds into residential construction.

3. Includes about $3.1 million which is the book value of the remaining portion of the original site for the new building.

4. In 1974, the Board assessed the Federal Home Loan Banks $40,000,000, and in 1977, another $5,000,000 for the total estimated cost to construct the new Federal Home Loan Bank Board building. As of December 31, 1978, the $45,000,000 assessment to the banks had been recorded as a deferred credit, less the $600,000 depreciation amount, which has been recognized as income.

FEDERAL HOME LOAN BANKS

FINANCIAL STATEMENTS

DECEMBER 31, 1978 AND 1977

SCHEDULE 4

FEDERAL HOME LOAN BANKS

COMBINED STATEMENT OF FINANCIAL CONDITION AT

DECEMBER 31, 1978 AND 1977

ASSETS	1976	1977
	(000 omitted)	(000 omitted)
CASH (note 2)	$ 201,148	$ 133,829
INVESTMENTS AT COST (note 3)	3,414,374	3,748,516
ADVANCES TO MEMBERS (note 4)	32,670,123	20,172,937
OTHER LOANS:		
Guaranteed by AID, net (note 5)	92,196	63,220
Other FHLBanks	37,900	133,500
Total other loans	130,096	196,720
ACCRUED INTEREST RECEIVABLE	172,127	133,621
BANK PREMISES AND EQUIPMENT	17,979	23,818
Less:		
Depreciation and amortization	(5,777)	(8,322)
Net book value	12,202	15,496
OTHER ASSETS:		
Investments in FHLMC (note 6)	100,000	100,000
Concessions and discounts on consolidated obligations—bonds	21,325	17,732
Deferred charges—FHLBB cost of quarters	41,952	42,094
Assessment—FHLBB operating expenses	-	-
Assessment—FHLBB capital expenditures	1,455	1,186
Other	2,115	3,453
Total other assets	166,847	164,465
Total assets	$36,766,917	$24,565,584

 SCHEDULE 4 (cont'd)

LIABILITIES AND CAPITAL	1978	1977
LIABILITIES:	(000 omitted)	(000 omitted)
Deposits and borrowings:		
Members--time	$ 5,163,084	$ 3,143,404
Members--demand	1,042,474	1,000,417
Other FHLBanks	37,900	133,500
Other borrowings	-	8,724
Total deposits and borrowings	6,243,458	4,286,045
Accrued interest payable	391,479	260,883
Consolidated obligations (note 7):		
Bonds	23,287,245	16,984,875
Discount notes	4,168,209	1,346,230
Less:		
Passthroughs to FHLMC	(2,346,000)	(2,322,100)
FHLBank's participations	25,109,454	16,009,005
Other liabilities:		
Accounts payable	1,937	1,487
Accounts payable--FHLBB operating expenses	553	1,499
Other	63,372	31,158
Total other liabilities	65,862	34,144
Total liabilities	31,810,253	20,590,077
CONTINGENCIES AND COMMITMENTS (notes 8, 10, 11, 12, and 13)		
CAPITAL:		
Capital stock outstanding (note 9)	4,120,452	3,295,089
Retained earnings:		
Legal reserve	495,601	415,657
Dividend stabilization reserve	27,976	-
Undivided profits	312,635	264,761
Total retained earnings	836,212	680,418
Total capital	4,956,664	3,975,507
Total liabilities and capital	$36,766,917	$24,565,584

The accompanying notes are an integral part of this financial statement.

SCHEDULE 5

FEDERAL HOME LOAN BANKS

COMBINED STATEMENT OF INCOME AND EXPENSE

FOR THE YEARS ENDED DECEMBER 31, 1978 AND 1977

	1978	1977
	(000 omitted)	(000 omitted)
INCOME:		
Interest on advances to members	$2,036,509	$1,230,485
Income from investments	320,767	310,655
Interest and fees on AID loans	9,847	4,776
Earned commitment fees	21,656	8,393
Income from data processing services	11,003	14,685
Other income	15,462	6,564
Total income	2,415,244	1,575,558
EXPENSES:		
Interest and other costs:		
Interest and concessions--consolidated obligations	1,581,283	1,149,514
Assessments—FHLBB:		
Operating expenses	7,272	6,740
Amortization of capital expenditures	354	
Amortization of cost of quarters	1,745	
Assessments—Office of Finance	2,574	2,902
Interest on deposits	370,737	174,788
Other interest	449	347
Total interest and other costs	1,964,414	1,334,291
Other operating expenses:		
Salaries and benefits	26,834	25,741
Fees and professional services	1,963	1,698
Travel expense	1,543	1,575
Telephone and transmission costs	2,860	2,851
Stationery and supplies	4,790	4,341
Cost of quarters	4,284	4,068
Depreciation—furniture and equipment	1,083	1,511
Equipment rental and expense	6,030	6,186
Other	1,729	1,665
Total other operating expenses	51,116	49,636
Total expenses	2,015,530	1,383,927
Net income	$ 399,714	$ 191,631

The accompanying notes are an integral part of this financial statement.

FEDERAL HOME LOAN BANKS

COMBINED STATEMENT OF RETAINED EARNINGS

FOR THE YEARS ENDED DECEMBER 31, 1978 AND 1977

	1978	1977
	-----(000 omitted)-----	
LEGAL RESERVE		
Balance, January 1	$415,657	$377,333
Add: Statutory transfer of net income	79,944	38,324
Balance, December 31	$495,601	$415,657
DIVIDEND STABILIZATION RESERVE		
Balance, January 1	-	-
Add: Transfer from net income	$ 27,976	-
Balance, December 31	$ 27,976	-
UNDIVIDED PROFITS		
Balance, January 1	$264,761	$257,521
Add: Net income	399,714	191,631
Subtotal	664,475	449,152
Deductions		
Statutory transfer of net income	79,943	38,324
Dividends paid on capital stock	243,918	146,065
Transfer to dividend stabilization reserve	27,976	-
Total deductions	351,837	184,389
Balance, December 31	$312,635	$264,761

Because of rounding, minor differences may occur in some totals. The accompanying notes are an integral part of this financial statement.

 SCHEDULE 7

FEDERAL HOME LOAN BANKS

COMBINED STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEARS ENDING DECEMBER 31, 1978 AND 1977

	1978	1977
	(000 omitted)	
FINANCIAL RESOURCES WERE PROVIDED FROM:		
Operations:		
Net income	$ 399,714	$ 191,631
Noncash charges/(credit) to income:		
Depreciation and amortization of fixed assets	1,709	2,078
Amortization of concessions on C/O bonds	8,328	6,186
Amortization of FHLBB assessments	2,099	-
Gain on sale of on-line data processing services	(5,254)	-
Other	(294)	(265)
Total from operations	406,302	199,630
Net proceeds from issuance of C/O:		
Bonds	8,188,220	3,933,436
Discount notes	7,384,664	3,726,763
Advances repaid	12,802,375	9,447,001
Proceeds from sale of capital stock	858,955	445,912
Proceeds from sale of on-line data processing services	6,514	
Net deposits/(advances) between other FHLBanks		
Increase/(decrease) in deposits	2,053,011	187,853
Increase/(decrease) in securities sold under agreements to repurchase		
Increase/(decrease) in accrued interest payable	130,597	(4,947)
Amortization of discount on C/O discount notes	148,078	22,567
Increase/(decrease) in other liabilities	32,006	(5,357)
Total financial resources provided	$32,010,724	$17,952,858
FINANCIAL RESOURCES WERE USED FOR:		
Payments on maturing C/O:		
Bonds	$ 1,897,633	$ 3,444,040
Discount notes	4,734,938	2,856,480
Advances made	25,299,560	13,757,907
Redemption of capital stock	33,590	39,437
Dividends on capital stock	243,918	146,065
Net additions to bank premises and equipment	(895)	1,727
Increase/(decrease) in investments	(334,142)	(2,330,296)
Increase/(decrease) in accrued interest receivable	38,504	49,292
Increase/(decrease) in other assets	30,300	18,820
Increase/(decrease) in cash	67,318	(30,614)
Total financial resources used	$32,010,724	$17,952,858

Because of rounding, minor differences may occur in some totals. The accompanying notes are an integral part of this financial statement.

FEDERAL HOME LOAN BANKS
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 1978 AND 1977

ORGANIZATION AND RELATED AGENCIES

The 12 District Federal Home Loan Banks (FHLBanks), together with their member institutions, comprise the FHLBank System. The FHLBank System is designed to promote home ownership through extensions of credit to savings and home financing institutions. Member institutions include all federally chartered savings and loan associations, and membership is also available to qualified institutions, such as State chartered savings associations and mutual savings banks.

The FHLBanks are instrumentalities of the Federal Government; they are owned by and serve as central credit banks for member institutions. A principal source of funds for the FHLBanks is sales to the public of debt instruments (consolidated obligations) which are the joint and several obligations of all FHLBanks.

The FHLBank System is governed and regulated by the Federal Home Loan Bank Board (FHLBBoard) which is an independent Federal agency in the executive branch of Government. The FHLBBoard is the chartering and regulatory authority for Federal savings and loan associations and it governs The Federal Home Loan Mortgage Corporation (Mortgage Corporation), which is a secondary mortgage market facility. The principal function of the Mortgage Corporation, which is owned by the FHLBanks, is to promote the flow of capital into the housing markets by establishing an active secondary market in residential mortgages. Further, the FHLBBoard governs the insurance of accounts in savings and loan associations through the Federal Savings and Loan Insurance Corporation (FSLIC). FHLBBoard expenses are met through assessments to the FHLBanks and FSLIC and assessments to member institutions for examinations.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The more significant accounting policies not described elsewhere in the notes to the financial statements are as follows:

a. Investments--Investment securities are stated at cost, adjusted for amortization of premiums and accretion of discounts.

b. Receivable from the Mortgage Corporation--Proceeds from certain consolidated obligations have been passed through to the Mortgage Corporation at the same interest rates and maturities as the related consolidated obligations. The Mortgage Corporation is effectively reimbursing the FHLBanks for interest; accordingly, the receivable from the Mortgage Corporation, related debt, interest expense, and interest income, have been offset and are not reflected in the financial statements.

c. Bank premises, furniture and equipment, and leasehold improvements—These assets are stated at cost less accumulated depreciation and amortization. Depreciation and amortization are computed on the straight-line method over the estimated useful lives of the property or life of the lease.

d. Federal Home Loan Bank Board Assessments—The FHLBBoard assesses the FHLBanks an amount sufficient to provide for the payment of the FHLBBoard's estimated operating expenses. The FHLBanks expense their pro rata share of the FHLBBoard assessment for operating expenses during the year in which the assessment is levied. The FHLBBoard also assesses the FHLBanks an amount sufficient to provide for the payment of the FHLBBoard's capital expenditures for furniture, equipment, and furnishings for its building. These assessments are treated as a deferred charge and amortization is computed on the straight-line method over a 5-year period, which began January 1, 1978.
In December 1974, the FHLBBoard assessed the FHLBanks $40,000,000 for the estimated construction cost of the FHLBBoard's new office building in Washington, D.C. The FHLBBoard assessed an additional $5,000,000 in May 1977. The FHLBBoard will request payment of the remaining $1,305,720 at such times as deemed necessary to meet the anticipated construction expenditures. This deferred charge for cost of quarters is amortized to expense over a 25-year period using the straight-line method, which began January 1, 1978.

e. Concessions on consolidated obligations—The amounts allowed dealers in connection with the sale of consolidated obligation bonds are deferred and amortized on the straight-line method to the maturity of the obligations. However, amounts applicable to the sale of consolidated obligation discount notes are charged directly to expense as incurred because of their short term maturities.

f. Unearned commitment fees—Advance commitment fees are received at the time the agreement is made. Nonrefundable fees of less than $1,000 are taken into income immediately and fees of $1,000 or more are amortized to income over the period of the commitment on a straight-line basis. Refundable fees are deferred until the commitment expires or the advance is made.

2. COMPENSATING BALANCES

The FHLBanks have agreed to maintain average collected cash balances with various commercial banks in consideration for certain services. These arrangements are informal and there are no legal restrictions as to the withdrawal of funds. The compensating balances were approximately $33,487,000 and $43,500,000 at December 31, 1978 and 1977, respectively.

3. INVESTMENTS

A comparison of the book value and market value follows:

	December 31, 1978	
	Book value	Market value
	------(000 omitted)------	
U.S. Treasury obligations	$ 2,200	$ 2,183
Federal funds sold	2,435,450	2,435,450
Term funds sold	250,000	250,000
Bankers acceptances	147,707	147,515
Securities held under resale agreement	97,000	97,000
Participation in the FHLBanks' Consolidated Securities Fund	482,017	481,941
	$3,414,374	$3,414,089

	December 31, 1977	
	Book value	Market value
	(000 omitted)	
U.S. Treasury obligations	$ 356,704	$ 356,582
Federal funds sold	1,267,200	1,267,200
Term funds sold	257,500	257,500
Bankers acceptances	1,191,270	1,190,956
Securities held under resale agreement	152,000	152,000
Participation in the FHLBanks' Consolidated Securities Fund	523,842	523,779
	$3,748,516	$3,748,017

FHLBanks' Consolidated Securities Fund (Fund) was established by the FHLBBoard to offer a centralized portfolio management system for securities of the FHLBanks. The Fund is managed by the Office of Finance of the FHLBanks. The Fund invests primarily in short term money market instruments.

4. ADVANCES TO MEMBERS

At December 31, 1978 and 1977, the FHLBanks had advances outstanding to members at interest rates ranging from 6.50 to 12.75 percent and from 5.75 to 9.50 percent, respectively, as summarized below:

	December 31, 1978	
Years to maturity	Amount	Weighted average interest rate
	(000 omitted)	(percent)
0-1	$12,074,333	8.80
1-2	8,024,716	8.49
2-3	5,418,754	8.44
3-4	3,023,342	8.33
4-5	2,345,693	8.33
5-10	1,775,285	8.25
After 10	8,000	8.00
	$32,670,123	8.56

Years to maturity	December 31, 1977 Amount	Weighted average interest rate
	(000 omitted)	(percent)
0-1	$ 7,120,546	7.43
1-2	6,519,990	7.79
2-3	2,711,261	7.58
3-4	1,381,733	7.73
4-5	987,831	7.75
5-10	1,451,576	7.88
After 10	-	-
	$20,172,937	7.64

Outstanding advances aggregating $27,740,362,862 at December 31, 1978, and $17,547,048,000 at December 31, 1977, respectively, were collateralized by pledged investment securities and first mortgage loans of the members which had a collateral value assigned by the FHLBanks of approximately $32,066,871,791 and $23,315,243,000 at December 31, 1978 and 1977, respectively.

The capital stock of the FHLBanks owned by borrowing members is pledged as additional collateral for outstanding advances.

The FHLBanks are participating in a below market interest rate advance program initiated in 1974 to support the housing industry. The advances may be prepaid without penalty, but only by tendering the related consolidated obligations sold to support this program. Advances of $3,479,976,900 were made under this program for a period of approximately 5 years at rates of 0.5 percent to 0.79 percent below the FHLBanks' cost of related 5-year consolidated obligations. The net interest cost of this program amounted to approximately $18,004,191 and $18,223,000 for 1978 and 1977, respectively. Remaining advances outstanding under this program at December 31, 1978 and 1977, were $2,899,401,400 and $3,356,782,000, respectively.

The FHLBanks are also participating in a Community Investment Fund, a 5-year advances program initiated in June of 1978. The program provides funds to members meeting eligibility criteria for active involvement in preserving and revitalizing older communities. As of December 1978, advances of $1,110,331,530 were outstanding under this program for an average maturity of 3.3 years at rates ranging from 7.65 percent to 9.25 percent. These rates are one-half of 1 percent below the estimated cost of issuing consolidated obligations of comparable maturities at the time the commitments to advance funds were made. The net interest cost of this program amounted to approximately $1,506,274 for 1978.

5. LOANS GUARANTEED BY THE AGENCY FOR INTERNATIONAL DEVELOPMENT

The Agency for International Development (AID) was established by the Foreign Assistance Act of 1961, as amended. Under Sections 221 and 222 of the act, AID issues guarantees backed by the full faith and credit of The United States of America to eligible U.S. investors ensuring against loss of investments, including unpaid accrued interest, in self-liquidating housing projects. The FHLBanks qualify as eligible investors.

Under contracts of guaranty, the FHLBanks may, without the approval of AID, sell participating interests to members of the FHLBank System. The outstanding loan balances are reported net of participations bearing interest rates ranging from 7.25 to 9.25 percent at December 31, 1978. The weighted average interest rates on AID loans outstanding at December 31, 1978 and 1977, are 8.34 and 8.06 percent, respectively. The December 31, 1978, loan balances mature between 1989 and 2007.

The FHLBanks receive service fees for these loans against which direct expenses associated with the financing arrangements are netted. The balance is deferred and amortized into income at 1 percent per month.

6. INVESTMENT IN THE MORTGAGE CORPORATION

The investment in the Mortgage Corporation is stated at cost and consists of 100,000 shares of nonvoting capital stock. The underlying book value of the Mortgage Corporation at December 31, 1978 and 1977, was approximately $202,035,000 and $177,000,000, respectively.

7. CONSOLIDATED OBLIGATIONS

Consolidated Federal Home Loan Bank obligations are the joint and several obligations of all Federal Home Loan Banks. The outstanding obligations of the FHLBanks, including the passthroughs to the Mortgage Corporation (see note 1) at December 31, 1978 and 1977, were $27,563,295,000 and $18,344,875,000, respectively.

Regulations require the FHLBanks to maintain in the aggregate, unpledged qualifying assets in an amount equal to the consolidated obligations outstanding. "Qualifying assets" are defined as cash, obligations of or fully guaranteed by the United States, secured advances, and federally insured or guaranteed mortgages. The FHLBanks were in compliance with this requirement at December 31, 1978 and 1977.

The following is a summary of the FHLBanks' participation in consolidated obligations:

	December 31, 1978		
	Bonds		
Years to maturity	Range of coupon rates	Weighted average coupon rate	Outstanding
			(000 omitted)
0-1	7.20-9.50	8.21	$ 6,176,545
1-2	6.65-9.75	7.95	6,250,000
2-3	6.60-9.55	7.87	2,140,000
3-4	7.45-8.63	8.00	2,610,000
4-5	7.30-9.00	8.20	1,160,700
5-10	7.38-8.75	7.60	2,760,000
		7.99	$21,097,245

	Discount notes	
	Book value	Par value
	(000 omitted)	
Due within 1 year	$4,012,209	$4,120,050

Years to maturity	December 31, 1977		
	Bonds		
	Range of coupon rates	Weighted average coupon rates	Outstanding
			(000 omitted)
0-1	7.25-9.38	7.93	$ 1,887,905
1-2	7.20-9.50	8.36	4,286,270
2-3	6.65-7.80	7.25	3,150,000
3-4	6.60-8.65	7.21	1,540,000
4-5	7.45-8.63	7.81	1,010,000
5-10	7.30-8.10	7.64	2,920,700
		7.77	$14,794,875

	Discount notes	
	Book value	Par value
	——(000 omitted)——	
Due within 1 year	$1,214,130	$1,227,900

The FHLBanks' participation, as shown above, is reported net of advances to the Mortgage Corporation in the form of passthroughs of the proceeds of certain consolidated obligations. The following is a summary of the passthroughs:

	December 31, 1978		
	Bonds		
Years to maturity	Range of coupon rates	Weighted average coupon rates	Outstanding
			(000 omitted)
0-1	-	-	-
1-2	7.50-9.45	8.47	$ 200,000
2-3	8.65	8.65	360,000
3-4	8.63	8.63	190,000
4-5	8.75	8.75	300,000
5-10	7.38-8.13	7.78	440,000
After 10	7.38-7.88	7.59	700,000
		8.13	$2,190,000

	Discount notes	
	Book value	Par value
	——(000 omitted)——	
Due within 1 year	$156,000	$152,275

	December 31, 1977		
	Bonds		
Years to maturity	Range of coupon rates	Weighted average coupon rates	Outstanding
			(000 omitted)
0-1	9.38	9.38	$ 300,000
1-2	9.45	9.45	100,000
2-3	-	-	-
3-4	8.65	8.65	360,000
4-5	8.63	8.63	190,000
5-10	7.38-8.75	8.20	540,000
After 10	7.38-7.88	7.59	700,000
		8.33	$2,190,000

8. <u>PROMISSORY NOTE PAYABLE TO U.S. TREASURY</u>

Section 11(i) of the Federal Home Loan Bank Act authorizes the Secretary of the Treasury, in his discretion, to extend credit to the FHLBanks aggregating not more than $4 billion; the terms, conditions, and interest rate to be determined by the Secretary. There are no outstanding borrowings from the U.S. Treasury at December 31, 1978 and 1977.

9. <u>CAPITAL</u>

The capital stock of the FHLBanks has a par value of $100 per share and may not be issued at a price less than par value. The stock is nonnegotiable and can be redeemed only at the FHLBanks, within legal limits.

Retained earnings of the FHLBanks consist of undivided profits, a legal reserve, and a dividend stabilization reserve. Each FHLBank must transfer 20 percent of its net income to the legal reserve semiannually until the reserve equals the capital stock amount. Thereafter, 5 percent of the FHLBank's net income must be allocated for this purpose.

Dividends may be paid to members annually on the capital stock issued and outstanding at December 31, based on the actual period that the stock is held during the year. They are paid only out of the current calendar year's earnings and the dividend stabilization reserve and may be paid in the form of capital stock. The maximum dividend rate permissible is a rate equal to the average cost of funds to all FSLIC insured savings and loan associations in the FHLBank District for the 6-month period ending June 30 of the current year. The FHLBank is also required to maintain a level of undivided profits so that the ratio of 5 years' average advances outstanding to undivided profits does not exceed 100 to 1.

The dividend stabilization reserve, authorized by the FHLBBoard in 1978, may be utilized to transfer a percentage of the FHLBank's current year's earnings remaining after the required transfer to the legal reserve and payment of the maximum dividend allowed. Funds made available by a decision to pay less than the maximum dividend permissible may also be placed in this reserve.

10. <u>ON-LINE DATA CENTER DIVESTITURE</u>

On December 5, 1977, the U.S. Court of Appeals for the Sixth Circuit affirmed the District Court's ruling that the FHLBBoard lacked statutory authority to permit any of the FHLBanks to offer data processing services to its members. All the on-line data processing centers were sold in 1978. Revenues from the on-line data processing centers were approximately $11,185,000 in 1978 and $14,957,000 in 1977.

11. EMPLOYEE RETIREMENT PLAN

The FHLBanks are participants in the Savings Associations Retirement Fund (Fund) and substantially all of their officers and employees are covered by the Fund. The FHLBanks' contributions are determined by the Fund. Pension costs charged to operating expenses were $2,703,492 in 1978 and $2,804,000 in 1977.

12. COMMITMENTS

Rental expense of $5,257,090 in 1978 and $5,161,156 in 1977 for premises and equipment has been charged to expense. Minimum rentals for each of the next 5 years and for the subsequent 5-year period are as follows:

Year	Total
	(000 omitted)
1979	$ 3,323,700
1980	3,174,314
1981	2,707,262
1982	2,443,265
1983	2,071,222
1984-1988	8,082,458
	$21,802,221

The FHLBanks' premise lease agreements provide for increases in basic rentals from increased property taxes and maintenance expense. Commitments for advances to members and to foreign borrowers under guaranteed loans totaled $1,437,120,000 and $18,900,000, respectively, at December 31, 1978.

As provided for in Section 306(c) of the Federal Home Loan Mortgage Act, the FHLBBoard has provided for the guarantee by the FHLBanks of certain borrowings of the Mortgage Corporation from the Federal Home Loan Bank of New York.

Each of the FHLBanks participates in the guarantee in proportion to its investment in the capital stock of the Mortgage Corporation (see note 6). The FHLBanks have guaranteed $2,190,000,000 of the Mortgage Corporation's borrowings from the Federal Home Loan Bank of New York, in the form of passthroughs of the proceeds of certain consolidated obligation bonds.

13. <u>CONTINGENCY</u>

In December 1976, a lawsuit was instituted against the Federal Home Loan Bank of San Francisco and the FHLBBoard members, claiming that there was no authority in the Federal Home Loan Bank Act for the San Francisco Bank to perform money order accounting, processing, and reconciliation functions for its members. On April 15, 1977, the District Court issued an order that prohibited the San Francisco Bank from performing such functions and related matters and prohibited the FHLBBoard from authorizing any of the FHLBanks to engage in money order related activities.

The FHLBBoard and the Federal Home Loan Bank of San Francisco have appealed this decision to the U.S. Court of Appeals for the Ninth Circuit, and the District Court has stayed its order pending appeal. While the outcome of this litigation cannot be predicted with certainty, counsel and management are of the opinion that the FHLBBoard and the San Francisco Bank have meritorious defenses to this suit. In the event that the FHLBBoard and the San Francisco Bank do not prevail, management of the FHLBanks is of the opinion that the impact on the FHLBanks' financial position and operations will not be material.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

FINANCIAL STATEMENTS

DECEMBER 31, 1978 AND 1977

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

COMPARATIVE STATEMENT OF FINANCIAL CONDITION

AT DECEMBER 31, 1978 AND 1977

	1978	1977
ASSETS:		
Cash	$ 114,589	$ 7,493,620
Receivables (note 5)	12,971,875	5,649,539
Investments at amortized cost (notes 1 and 2)	5,204,933,587	4,789,897,294
Accrued interest on investments	86,617,550	76,917,685
Assets acquired from insured institutions, net (note 3)	42,037,071	29,226,595
Loans to insured institutions and accrued interest, net (note 5)	22,404,510	16,189,148
Subrogated accounts and related interest, net (note 3)	-	2,214,957
Deferred charges and other assets (note 1)	107,888	115,768
Total	$5,369,187,070	$4,927,704,606
LIABILITIES AND RESERVES:		
Miscellaneous accrued and other liabilities	$ 5,685,758	$ 8,465,704
Allowance for estimated losses for contribution agreements (notes 3 and 4)	30,510,927	42,723,917
Deferred credits	4,741,385	3,746,509
Primary reserve (cumulative net income)	4,227,765,462	3,652,998,862
Secondary reserve (premium prepayments)	1,100,483,538	1,219,769,614
Total	$5,369,187,070	$4,927,704,606

The accompanying notes are an integral part of this financial statement.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

COMPARATIVE STATEMENT OF INCOME, EXPENSE, AND PRIMARY RESERVE

FOR THE YEARS ENDED DECEMBER 31, 1978 and 1977

	1978	1977
INCOME:		
Insurance premiums (note 1)	$ 331,112,550	$ 293,328,229
Interest on investments	358,552,422	320,569,352
Interest on loans to insured institutions	731,736	802,270
Interest on subrogated accounts	16,696,490	-
Income on assets acquired from insured institutions	2,000,999	2,005,371
Interest income on notes receivable and advanced contributions (note 5)	527,277	231,314
Miscellaneous income (note 5)	18,147	30,706
Nonoperating income	133,272	6,193,602
Total income	709,772,893	623,160,844
EXPENSES:		
Administrative expenses	765,349	873,934
Services rendered by Federal Home Loan Bank Board	21,527,595	20,755,996
Insurance settlement and other expenses	22,668,261	4,582,415
Unallocated nonadministrative expenses	905,763	686,404
Net provision for losses (note 3)	9,791,240	24,606,239
Interest applied to members' equity in secondary reserve	79,348,085	85,892,932
Total expenses	135,006,293	137,397,920
Net income	$ 574,766,600	$ 485,762,924
PRIMARY RESERVE:		
Balance, beginning of year	$3,652,998,862	$3,167,235,938
Net income transferred to primary reserve	574,766,600	485,762,924
Balance, end of year	$4,227,765,462	$3,652,998,862

The accompanying notes are an integral part of this financial statement.

 SCHEDULE 10

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

COMPARATIVE STATEMENT OF CHANGES IN FINANCIAL POSITION

FOR THE YEARS ENDED DECEMBER 31, 1978 AND 1977 (note 5)

	1978	1977
FINANCIAL RESOURCES WERE PROVIDED BY:		
Operations:		
Income:		
Insurance premiums (other than transfer from secondary reserve to pay insurance premiums of $96,649,976 and $85,921,884 in 1978 and 1977) (note 1)	$234,462,574	$207,406,344
Interest on investments (net of $1,222,896 and $3,958,861 in amortized net discounts for 1978 and 1977)	357,329,525	316,610,491
Interest on loans to insured institutions (note 5)	1,259,014	1,033,585
Interest from subrogated accounts	16,696,490	-
Income on assets acquired from insured institutions	2,000,999	2,005,371
Other income (note 5)	151,419	6,224,308
Total	611,900,021	533,280,099
Less expenses:		
Administrative expenses	765,349	873,934
Services rendered by FHLBB	21,527,595	20,755,996
Insurance settlement and other expenses	22,668,260	4,582,415
Unallocated nonadministrative expenses	905,763	686,404
Net resources provided by operations	566,033,054	506,381,350
Decrease/(increase) in:		
Loans to insured institutions and accrued interest (note 5)	(6,215,363)	2,067,217
Subrogated accounts in insured institutions in liquidation and related interest	2,214,956	6,964,673
Losses on assets acquired (note 3)	3,764,579	2,754,688
Provision for losses--subrogated accounts	-	453,560
Cash	7,379,031	(7,230,641)
Increase/(decrease) in:		
Deferred credits	994,877	2,420,271
Total resources provided	$574,171,134	$513,811,118

 SCHEDULE 10 (cont'd)

	1978	1977
FINANCIAL RESOURCES WERE APPLIED TO:		
Net additions in investments	$413,813,397	$388,189,135
Refund of secondary reserve	101,984,184	93,082,920
Contributions to insured institutions	21,504,231	21,756,671
Increase/(decrease) in:		
Accrued interest on investments	9,699,865	1,863,621
Assets acquired from insured institutions (note 3)	17,07[illegible],055	6,988,010
Accounts receivable (note 5)	7,322,335	1,309,671
Deferred charges and other assets (note 5)	(7,879)	79,421
Decrease/(increase) in:		
Miscellaneous accrued and other liabilities	2,779,946	541,669
Total r[illegible]urces applied	$574,171,134	$513,811,118

The accompanying notes are an integral part of this financial statement.

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1978 AND 1977

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Investments

Investment securities are stated at cost, adjusted for amortization of premiums and accretion of discounts. Such amortization and accretion are computed on the "constant yield" method at rates based upon the lives of the related securities and are recognized as an adjustment to interest income on investments.

b. Furniture and equipment

These assets are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the property. The net balance of this account is insignificant and is included in other assets.

c. Income recognition

Insurance premium income is recognized as earned when member institutions are assessed.

2. INVESTMENTS

The investments at December 31, 1978 and 1977 are as follows:

	1978		1977	
	Book value	Market value	Book value	Market value
	(000,000 omitted)			
U.S. Treasury obligations	$5,119.4	$4,780.1	$4,658.5	$4,573.6
Federal agency securities	85.5	72.8	131.4	122.5
Total	$5,204.9	$4,852.9	$4,789.9	$4,696.1

3. ALLOWANCES FOR POSSIBLE LOSSES

An analysis of the changes in the allowances for possible losses on the accounts described below for years ended December 31, 1978 and 1977, follows:

	1978	1977
Assets acquired from insured institutions		
Balance, beginning of period	$ 8,738,247	$ 5,633,559
Add: Provision charged to expense	500,000	350,000
Add: Adjustment due to acquisition	4,393,567	3,130,093
Less: Losses on assets acquired	628,988	375,405
Balance, end of period	$13,002,826	$ 8,738,247
Contribution agreements		
Balance, beginning of period	$42,723,917	$39,770,789
Add: Provision charged to expense	9,291,240	24,709,799
Less: Contributions paid out	21,504,230	21,756,671
Balance, end of period	$30,510,927	$42,723,917

4. ALLOWANCE FOR ESTIMATED LOSSES FOR CONTRIBUTION AGREEMENTS

FSLIC enters into contribution agreements to restore an insured institution to normal operations and, under these arrangements, agrees to make, or commits itself to make, a cash contribution. The remaining contingent liability under these agreements totaled $88,147,778 and $104,950,283 at December 31, 1978 and 1977, respectively.

5. LOANS TO INSURED INSTITUTIONS

Loans to insured institutions include advance payments made by FSLIC to associations in default prevention actions. Advance payments and related interest amounted to $10,353,616 in 1978 and $2,075,616 in 1977.

6. STATEMENT FORMAT

Certain 1977 figures vary from prior year annual statement due to reclassification. Statement format has been standardized in 1978.

FEDERAL HOME LOAN MORTGAGE CORPORATION

FINANCIAL STATEMENTS

DECEMBER 31, 1978 AND 1977

 SCHEDULE 11

FEDERAL HOME LOAN MORTGAGE CORPORATION

BALANCE SHEET

FOR YEARS ENDED DECEMBER 31, 1978 AND 1977

ASSETS	December 31 1978	December 31 1977
	-----(000 omitted)-----	
MORTGAGE LOANS, AT UNPAID PRINCIPAL BALANCES (notes 1 and 4):		
Insured by Federal Housing Administration (FHA) or guaranteed by Veterans Administration (VA)	$ 1,298,895	$1,450,321
Participation in conventional mortgages	1,599,536	1,450,756
Conventional mortgages	192,336	365,892
	3,090,767	3,266,969
Less:		
Unamortized mortgage purchase discount (note 1)	53,105	62,859
Allowance for possible losses (note 5)	9,000	9,000
Total mortgage loans	3,028,662	3,195,110
CASH AND TEMPORARY CASH INVESTMENTS	334,852	121,367
ACCRUED INTEREST RECEIVABLE	26,576	25,559
ACCOUNTS RECEIVABLE AND OTHER ASSETS	66,763	28,982
CLAIMS AGAINST FHA AND VA, NET OF ALLOWANCE FOR LOSSES OF $100,000	1,012	1,201
REAL ESTATE OWNED, AT THE LOWER OF COST OR ESTIMATED REALIZABLE VALUE	2,673	2,618
UNAMORTIZED MORTGAGE SALES DISCOUNT AND DEBT EXPENSE	235,701	126,365
Total assets	$ 3,696,239	$3,501,202

The accompanying notes are an integral part of this financial statement.

 SCHEDULE 11 (cont'd)

	December 31 1978	December 31 1977
	——(000 omitted)——	
LIABILITIES AND STOCKHOLDERS' EQUITY		
NOTES AND BONDS PAYABLE (note 7)	$ 3,065,586	$3,109,692
OTHER LIABILITIES:		
Accrued interest	43,657	51,709
Accounts payable and other accrued expenses	1,574	24,489
Principal and interest due to Mortgage Participation Certificate investors	199,892	117,673
Total liabilities	3,310,709	3,303,563
RESERVE FOR MANAGEMENT FEE AND GUARANTEES (note 3)	33,500	21,000
CONTINGENCIES (note 2):		
Mortgage Participation and Guaranteed Mortgage Certificates	12,016,759	6,764,723
Less:		
Underlying mortgage loans sold	12,016,759	6,764,723
Total contingencies	-	-
SUBORDINATED CAPITAL DEBENTURES AT 9.375 PERCENT (note 8)	150,000	-
COMMITMENTS (note 6)		
STOCKHOLDERS' EQUITY:		
Common stock, nonvoting, $1,000 par value; no maximum authorization; 100,000 shares issued and outstanding	100,000	100,000
Capital in excess of par value (note 9)	75,000	-
Retained earnings	27,030	76,639
Total stockholders' equity	202,030	176,639
Total liabilities and capital	$ 3,696,239	$3,501,202

The accompanying notes are an integral part of this financial statement.

SCHEDULE 12

FEDERAL HOME LOAN MORTGAGE CORPORATION

STATEMENT OF INCOME AND RETAINED EARNINGS

	Years ended December 31				
	1978	1977	1976	1975	1974
INCOME:	(000 omitted)				
Interest and discount on mortgage loans, net (note 1)	$235,393	$288,673	$369,928	$397,526	$257,115
Management and guarantee fee (note 2)	13,595	8,956	3,271	3,285	1,904
Interest on temporary cash investments	44,693	13,338	66,657	41,053	35,581
Other income	2,576	3,394	4,059	3,535	885
Total income	296,257	314,361	443,915	445,399	295,485
EXPENSES:					
Interest on borrowings and related costs	242,478	270,784	419,058	407,745	250,362
Provision/(credit) for losses, management fee and guarantees (note 2)	12,874	8,218	(995)	11,386	32,577
Commitment fees	1,235	2,952	1,005	587	-
Administrative	14,279	11,744	10,686	10,173	7,554
Total expenses	270,866	293,698	429,754	429,891	290,493
RETAINED EARNINGS:					
Net income	25,391	20,663	14,161	15,508	4,992
Retained earnings, beginning of year	76,639	55,976	41,815	26,307	21,315
Transfer to capital in excess of par value	(75,000)	-	-	-	-
Retained earnings, end of year	$ 27,030	$ 76,639	$ 55,976	$ 41,815	$ 26,307

The accompanying notes are an integral part of this financial statement.

FEDERAL HOME LOAN MORTGAGE CORPORATION

STATEMENT OF CHANGES IN FINANCIAL POSITION

	Years ended December 31				
	1978	1977	1976	1975	1974
	(000 omitted)				
FUNDS PROVIDED:					
Net income	$ 25,391	$ 20,663	$ 14,161	$ 15,503	$ 4,992
Charges/(credits) to income not affecting funds:					
Amortization of mortgage purchase discount (note 1)	(9,021)	(6,265)	(7,501)	(7,668)	(6,545)
Amortization of mortgage sales discount and debt expense (note 1)	22,350	5,663	2,353	1,643	1,261
Provision/(credit) for losses, management fee and guarantees (note 2)	12,874	8,218	(995)	11,386	32,577
Funds provided from operations	51,594	28,279	8,018	20,869	32,285
Mortgage loan principal repayments	291,130	446,279	456,469	290,538	156,659
Proceeds from issuance of notes and bonds, net of debt expense	448,855	537,269	-	211,023	1,696,400
Proceeds from advances for Special U.S. Treasury Program (note 10)	-	-	-	879,500	695,000
Mortgage loans sold:					
Mortgage Participation Certificates, net of repurchases	5,585,393	3,966,627	937,297	452,111	42,771
Guaranteed Mortgage Certificates	693,850	594,300	398,200	497,250	-
FHA/VA	-	7,064	35,425	66,939	-
Increase/(decrease) in short term discount notes	20,551	131,360	-	(147,600)	147,600
Other items, net	828	27,252	(18,525)	50,959	788
Total funds provided	$7,092,201	$5,738,430	$1,816,8[illegible]	$2,321,589	$2,771,503

SCHEDULE 13 (cont'd)

	1978	1977	1976	1975	1974
	Years ended December 31 (000 omitted)				
FUNDS APPLIED:					
Mortgage loans purchased, net of discount:					
Regular programs	$6,510,711	$4,116,007	$1,125,188	$ 828,808	$1,488,570
Special U.S. Treasury Program (note 10)	-	-	-	875,672	677,196
Notes and bonds retired	368,006	913,482	698,878	2,023	554,935
Repayments of advances for Special U.S. Treasury Program - (note 10)	-	1,171,741	387,453	15,306	-
Increase/(decrease) in cash and temporary cash investments	213,484	(462,800)	(394,635)	599,780	50,802
Total funds applied	$7,092,201	$5,738,430	$1,816,884	$2,321,589	$2,771,503

The accompanying notes are an integral part of this financial statement.

FEDERAL HOME LOAN MORTGAGE CORPORATION

NOTES TO FINANCIAL STATEMENTS

DECEMBER 31, 1978 AND 1977

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Recognition of Gain (Loss) on Mortgage Loans

The Federal Home Loan Mortgage Corporation (the "Corporation") provides for estimated losses on mortgage loan purchases, including outstanding commitments, which may be incurred upon the funding of such purchases through a security sale, or upon sale of the loans, and provides allowances for uninsured losses. To the extent a loss is indicated on the financing of mortgage loans, the loss attributable to such financing is charged against the allowance for possible losses which is reflected in the balance sheet as a reduction of mortgage loans. This reduction in the mortgage loans results in additional yield which is recognized over the term of the related borrowing. To the extent a loss is indicated on the sale of mortgage loans in the form of Mortgage Participation Certificates (PCs) or Guaranteed Mortgage Certificates (GMCs), the loss attributable to such sales (including estimated future administrative costs) is recognized currently. Gains or losses on outright sales of mortgage loans without recourse to the Corporation are recognized at the time of sale.

Mortgage purchase and sales discount

Discount on mortgage loans purchased is recorded as income over the life of the related mortgage loans using the level yield method.

Mortgage Participation Certificates and Guaranteed Mortgage Certificates (see note 2) may be sold at discounts. Discount on Mortgage Participation Certificates is amortized over the life of the related mortgage loans, and discount on Guaranteed Mortgage Certificates is amortized over the period to the optional repurchase date, both using the level yield method. This amortization is recorded as a reduction of management and guarantee fee income in the accompanying financial statements.

Effective January 1, 1978, the Corporation increased the rate of amortization of mortgage purchase and sales discount based on its revised estimate of the average life of the related mortgage loans. The effect of this change was to decrease net income by $5.067 million for the year ended December 31, 1978.

Amortization of debt expense

Debt expense is amortized over the period during which the related indebtedness is outstanding.

Commitment fees

Commitment fees received/paid are deferred and treated as additional mortgage purchase/sales discount when delivery occurs, or recognized as income/expense if delivery does not occur.

2. MORTGAGE LOAN SALES AND RELATED MATTERS

The Corporation sells PCs and GMCs representing undivided interest in mortgage loans. The Corporation guarantees the timely payment of interest and the collection of principal on the underlying mortgage loans. Sales of PCs and GMCs provide for the Corporation to manage and guarantee the underlying mortgage loans. If the Corporation's net yield after estimated management fee and guarantee is less than the effective rate payable to the investor, the Corporation recognizes the estimated loss ("negative interest margin") currently. Interest margin, representing the excess of the effective interest income rate to the Corporation over that payable to the investor, is recognized as earned over the life of the related mortgage loans and is reported as management and guarantee fee income in the accompanying financial statements.

Holders of PCs receive interest monthly at the certificate rate together with their pro rata share of principal payments received by the Corporation. The issued certificates have been accounted for as sales, and the mortgage loans and the certificates issued are accordingly excluded from the Corporation's mortgage portfolio. Unpaid balances of the outstanding certificates were approximately $10.152 billion and $5.408 billion at December 31, 1978, and December 31, 1977, respectively. At December 31, 1978, the weighted average remaining term to maturity of the related mortgage loans was 28 years. At December 31, 1978, and December 31, 1977, the excess effective interest income rate to the Corporation over that payable to the PC investor was 0 percent and 0.16 percent, respectively. The effective interest income rate to the Corporation and effective rate payable to the investor have been adjusted to semiannual yield equivalent.

Holders of GMCs are paid interest semiannually at the certificate rate, and annually their pro rata share of principal collected or specified minimum annual principal reductions, whichever is greater. Any GMC holder may, at his option, require the Corporation to repurchase such certificates on a designated "optional repurchase date" at the then unpaid principal balance. At December 31, 1978, such optional repurchase dates range from March 15, 1990, to September 15, 2003. At December 31, 1978, and December 31, 1977, outstanding GMCs totaled $1.865 billion and $1.356 billion, respectively, and the excess effective interest income rate to the Corporation over that payable to the GMC investor was 0.36 percent and 0.39 percent, respectively. The effective interest income rate to the Corporation has been adjusted to semiannual yield equivalent.

As the Corporation recognizes estimated losses attributable to "negative interest margin" on PCs and GMCs currently, management believes that the principal risk to the Corporation subsequent to the consummation of PC and GMC sales relates to its guarantees of the timely payment of interest, the collection of principal on the underlying mortgage loans, and the recovery of future administrative costs relative to the PC and GMC programs.

The maximum contingent liability of $12.017 billion at December 31, 1978, plus interest, is offset by a like amount of interest bearing mortgage loans underlying the PCs and GMCs, including principal collections held in the GMC Trusts of $146 million at December 31, 1978, and $141 million at December 31, 1977. In management's opinion, the $33.5 million reserve for management fee and guarantees is adequate to absorb any losses anticipated at December 31, 1978. In addition, assuming that the mortgage loans underlying the PCs and GMCs have a weighted average life of 7.73 years (which approximates the weighted average life of the 8-year prepayment assumption), gross interest margin of $409 million, representing the excess of the mortgage coupon over the PC or GMC certificate rate will become available to absorb future losses, unamortized mortgage sales discounts, and administrative costs attributable to the PCs and GMCs outstanding at December 31, 1978. The $409 million is an estimate based on assumptions concerning the life of the mortgages. If the actual mortgage loan repayment experience should differ from the assumptions, the resultant amount of interest margin also would be different.

3. RESERVE FOR MANAGEMENT FEE AND GUARANTEES

An analysis of the changes in the Reserve for Management Fee and Guarantees for the years ended December 31, 1978, and December 31, 1977, follows:

	December 31 1978	1977
	—(000 omitted)—	
Balance, beginning of period	$21,000	$13,116
Provision reflected in current earnings	12,848	8,174
Loss on mortgages sold	(348)	(290)
Balance, end of period	$33,500	$21,000

4. MORTGAGE LOANS

As of December 31, 1978, and December 31, 1977, the effective net yield on mortgage loans, adjusted to semiannual yield equivalent and adjusted for the effect of discount amortizations, less servicing fees, was as follows:

	December 31 1978	1977
	—(percent)—	
FHA and VA mortgages	8.11	7.88
Participation in conventional mortgages	9.96	9.09
Conventional mortgages	9.89	9.10

5. ALLOWANCE FOR POSSIBLE LOSSES ON MORTGAGE LOANS

An analysis of the changes in the Allowance for Possible Losses on Mortgage Loans for the years ended December 31, 1978, and December 31, 1977, follows:

	December 31 1978	1977
	—(000 omitted)—	
Balance, beginning of period	$9,000	$9,000
Provision charged to current earnings	26	44
Loss on mortgages sold	(26)	(44)
Balance, end of period	$9,000	$9,000

6. COMMITMENTS

The Corporation's outstanding commitments to purchase and sell mortgage loans at December 31, 1978, and December 31, 1977, are summarized as follows:

Commitments to purchase

The average contract rate on commitments to purchase mortgage loans is determined after deducting servicing fees. Delivery of mortgages under the 6-month and 8-month forward commitment programs is at the option of the seller; delivery is mandatory under all other commitment programs, and must occur within 60 days of the contract date.

Commitments to sell

The Corporation's PCs are continuously offered for sale under both mandatory and optional delivery programs. Delivery periods range from 7 to 150 days under the mandatory program. Offers where delivery is at the Corporation's option have settlements between 120 and 270 days from the date of the contract. The Corporation pays commitment fees ranging up to 1.0 percent depending on the length of delivery period and the specific program being offered at the time of sale.

Commitments to Purchase

	December 31, 1978		December 31, 1977	
	Average contract rate (note a)	Amount	Average contract rate (note a)	Amount
	(percent)	(000 omitted)	(percent)	(000 omitted)
FHA/VA	-	$ -	8.56	$ 10,000
Conventional mortgages				
Home	10.21	896,595	8.93	734,000
Multifamily	10.38	27,125	9.27	21,000
Forward programs	10.33	486,608	8.81	298,000
		$1,410,328		$1,063,000

a/The average contract rates have been computed based on an 8-year prepayment assumption.

Commitments to Sell

	December 31, 1978		December 31, 1977	
	Average effective rate payable to investor (note a)	Amount	Average effective rate payable to investor (note a)	Amount
	(percent)	(000 omitted)	(percent)	(000 omitted)
Mandatory	9.69	$210,600	8.59	$470,000
Optional	9.93	281,000	8.59	295,000
		$491,600		$765,000

a/The average effective rate payable to investor has been computed based on an 8-year prepayment assumption.

7. NOTES AND BONDS PAYABLE

A summary of notes and bonds payable is as follows:

	Maturity	December 31, 1978 Effective interest rate	December 31, 1978 Balance	December 31, 1977 Effective interest rate	December 31, 1977 Balance
		(percent)	(000 omitted)	(percent)	(000 omitted)
Advances from the FHLBank (passthrough of short term discount notes)	1979	8.71	$ 156,000	6.24	$ 132,100
Bond payable to bank	1986	7.75	17,927	7.75	18,748
Notes to the FHLBank (passthrough of Consolidated Federal Home Loan Bank Obligations)	1978	-	-	9.43	300,000
	1979	8.54	200,000	9.50	100,000
	1981	8.69	360,000	8.69	360,000
	1982	8.65	190,000	8.65	190,000
	1984	8.78	300,000	8.78	300,000
	1985	7.84	440,000	7.58	240,000
	1983/1993	7.41	400,000	7.41	400,000
	1987/1997	7.91	300,000	7.91	300,000
			2,190,000		2,190,000
Mortgage-Backed Bonds	1978	-	-	5.30	51,375
	1979	6.06	103,580	6.06	103,580
	1980	5.36	197,593	5.36	198,903
	1985	5.33	3,461	5.33	3,461
	1983/1995	8.69	112,025	8.69	119,025
	1984/1996	7.84	135,000	7.84	142,500
	1982/1997	7.25	150,000	7.25	150,000
			701,659		768,844
Notes and bonds payable			$3,065,586		$3,109,692

Scheduled principal payments for all notes and bonds payable due for each of the next 5 years are as follows:

Year	Payment
	(000 omitted)
1979	$476,347
1980	$211,683
1981	$375,544
1982	$205,620
1983	$ 15,727

The bond payable to bank is collateralized by a like amount of FHA/VA mortgages and calls for specific annual principal repayments ranging from $882,000 to $1,408,000 over the remaining life of the bond with the balance due at maturity.

The 1982/1997, 1983/1995, and 1984/1996 Mortgage-Backed Bonds and the 1983/1993 and 1987/1997 Notes to the Federal Home Loan Bank are redeemable at the Corporation's option commencing 1982, 1983, 1984, 1983, and 1987, respectively, at their face value. On the 1983/1995 and 1984/1996 bonds, a sinking fund provides for annual retirements of $7.0 million and $7.5 million principal amount of bonds, respectively, which commenced in 1976 and 1977. In addition, the Corporation has a noncumulative option to increase the sinking fund amounts each year by an amount not exceeding the annual retirement amounts. The 1980 bond calls for specific semiannual principal repayments ranging from $335,000 to $1,115,000 over the remaining life of the bond, with the balance due at maturity.

All Mortgage-Backed Bonds are guaranteed as to principal and interest by the Government National Mortgage Association (GNMA). Under the provision of a Trust Indenture with GNMA dated October 26, 1970, and supplements thereto, the Corporation conveyed mortgages to the Trust as security for the Mortgage-Backed Bonds. As of December 31, 1978, and December 31, 1977, Trust assets of approximately $800 million and $1.3 billion, respectively, constituting primarily principal balances of such mortgages, are restricted for the payment of principal and interest on the Mortgage-Backed Bonds and are included in the accompanying balance sheet.

The FHLBanks are required to maintain certain assets equal to their outstanding consolidated obligations. With respect to $100 million of the notes to the Federal Home Loan Bank maturing in 1979, and $200 million maturing in 1985, the Corporation may be required to pledge a portion of its FHA/VA mortgages retained in portfolio to collateralize a portion or all of the $300 million obligation for the periods during which the FHLBanks do not meet their aforementioned requirements.

8. SUBORDINATED CAPITAL DEBENTURES

The Subordinated Capital Debentures, due December 27, 1988, are subordinated to all obligations and liabilities of the Corporation, including obligations of others that the Corporation has guaranteed, whether existing on the date of issuance or thereafter incurred or created.

9. RECAPITALIZATION

On July 27, 1978, the Corporation Board of Directors authorized a transfer of $75 million from the Corporation's retained earnings to the Corporation's capital in excess of par value, effective June 30, 1978.

10. SPECIAL U.S. TREASURY FUNDED PROGRAM

Pursuant to a joint United States Department of the Treasury-Federal Home Loan Bank System program, the Corporation, in 1974 and 1975, acquired $1.575 billion aggregate principal balance of conventional mortgage loans. This program was financed by loans from the Treasury to the Bank System, which in turn passed through the funds to the Corporation. During 1976 and 1977, the outstanding principal balance of the Advances for Special U.S. Treasury Program was retired with the final payment made on February 25, 1977.

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