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Improving U.S. Housing Finance: Assessing Options for the Future of Fannie Mae and Freddie Mac

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Goals for Secondary Market

- Access to Liquid Credit Markets Nationwide
- Counter-cyclical Stability
- Favoring of Safe Products that are Well-Priced and Clearly Understood by Borrowers
- Provision of Credit for the Underserved

Advantages/Disadvantages of Fannie/Freddie Model

■ Key Advantages:

- Liquidity for mortgages, including affordable 30-yr fixed rate mortgage
- Standard underwriting criteria, investment products, documentation
- Provided access to credit during downturns (with help from the Fed)
- Supported market for multifamily finance
- Some support for lending to underserved markets

■ Key Disadvantages

- Implicit guarantee created moral hazard (as privately-owned corporation sought to maintain/grow profits/market share)
 - Lowered underwriting standards and distorted portfolio investments
- Political power allowed them to evade proper regulatory oversight.
- Large size → TBTF
- Implicit subsidy not well-targeted to underserved borrowers

Framework for Evaluating Reforms: Two Critical Elements

■ **Credit Enhancement**

- Federal guarantee/wrap for catastrophic risk
- Decisions about nature of guarantee:
 - Guarantee of corporate debt vs. MBS?
 - Explicit vs. implicit?
 - Subsidized vs. actuarially-priced?
 - All mortgages vs. selected/"favored" products?
- Raises danger of moral hazard

■ **Regulation** of all players in the mortgage market

Framework for Evaluating Reforms: Other Important Questions

- Requirements for serving lower income and multi-family markets?
- Limits on allowable direct investments?
- Limits on securitization of non-favored products?
- How many players?
- Methods of ownership?
 - Full nationalization
 - Public utility (investor owned but regulation of fees and profits)
 - Cooperative ownership (FHLB model?)
 - Improved pre-conservatorship, status-quo
 - Full privatization (no government backing)

Transition Issues

- Risks/benefits of remaining in conservatorship
- Risks inherent in adopting a new structure
 - Disruption of mortgage markets.
 - Loss of key/specialized staff/systems, etc.
- Other issues
 - How to handle preferred stock held by Treasury?
 - How to handle toxic assets?
 - How to work down existing mortgage portfolio?
 - How to handle LIHTC portfolio?

Evaluating Specific Proposals

- Key Proposals: Center for American Progress, Credit Suisse, Mortgage Bankers Association, Housing Policy Council
- Similarities:
 - Privately-owned participants take first risk
 - Explicit govt. guarantee supported by a fee, available to defined set of mortgages that meet specific criteria
- Differing Levels of Concern Regarding:
 - Serving lower income and multi-family markets
 - Regulating the private label securities market
 - Ensuring a smooth transition