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 \(\Rightarrow\) 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