

GSEs inflated subprime balloon before it popped: Cato Institute

Posted By [KERRI PANCHUK](#) On March 15, 2011 @ 1:10 pm | [No Comments](#)

Fannie Mae and **Freddie Mac** played an integral role in expanding the subprime bubble before it burst, researcher Mark Calabria of the **Cato Institute** said in a new report.

Calabria challenges the notion that Wall Street greed held Fannie and Freddie hostage, forcing them to focus heavily on the subprime segment that eventually led to record losses and a recession.

Instead, the researcher paints the government-sponsored enterprises as culprits in the subprime debacle by citing data showing Fannie and Freddie acquired 40% of all newly issued private-label subprime securities issued during the housing boom years of 2003 and 2004.

"Painting Wall Street and the GSEs as competitors fails to account for the fact that Wall Street firms and their affiliates were among the largest mortgage sellers to Fannie and Freddie," Calabria said.

Companies such as **Citibank** ([C](#)^[1]: 4.455 +0.34%), **JPMorgan Chase** ([JPM](#)^[2]: 44.42 - 0.43%), **Lehman Brothers**, **Morgan Stanley** (:) and **Goldman Sachs** ([GS](#)^[3]: 156.705 - 0.35%) "all did significant business selling mortgages to the GSEs," he said.

Calabria believes the GSEs' profit goals encouraged them to focus more heavily on subprime.

In the early part of the decade, he says a decline in refinancing volumes offset increases in new purchase volumes, which reduced fees for the mortgage industry and GSEs. All of this put pressure on GSE profits, prompting the entities to search for income elsewhere. Fannie and Freddie found that income in subprime, according to the Cato Institute report.

The GSEs significant presence in the market is evident when considering their relationship to former subprime lender **Countrywide Financial Corp.**, which was acquired by **Bank of America** ([BAC](#)^[4]: 13.97 +0.07%) in 2008, Calabria said.

"At the market's peak in 2005, only 10 lenders made up two-thirds of Fannie Mae's business, and 10 lenders also made up over three-fourths of Freddie Mac's business," he explained. "Near the top for both was Countrywide Mortgage, one of the nation's largest subprime lenders. In 2005, one out of every four loans purchased by Fannie Mae was from Countrywide. One of out every 10 for Freddie Mac was also from Countrywide."

Government housing goals are to blame, he said, as federal homeownership policies encouraged a dramatic decline in Fannie and Freddie's underwriting guidelines. In 2001, the **Department of Housing and Urban Development** heightened goals for assisting low- to moderate-income homebuyers, which forced the GSEs to further erode underwriting guidelines to keep up with the

policymakers' homeownership goals, according to Calabria.

Disclosures Fannie Mae made to the **Securities and Exchange Commission** earlier in the decade alluded to concerns they had over housing goals creating credit risks, Calabria reported.

"As a staffer for the Senate Banking Committee, I also remember a meeting in 2007 with senior Freddie Mac executives where they expressed a deep concern that both the housing goals and congressional pressure to extend lending to riskier borrowers were going to result in substantial losses," he said. "After their accounting scandals in 2003 and 2004, both Fannie and Freddie were facing the possibility of substantial new regulation."

While Calabria advocates for the GSEs to have no role in the mortgage market, other institutions believe a dramatically reduced role would have the unintended consequence of hurting borrowers who were never a systematic risk.

"A reliable secondary market is essential so that the nation's Main Street community banks can continue to offer residential mortgages to their customers," said Jim MacPhee, chairman of the **Independent Community Bankers of America**, earlier this year.

MacPhee advocates a return to common sense-oriented underwriting guidelines, but warns an absence of some type of public backing for the mortgage market could spell an end to loan sources rural Americans have come to rely upon.

Write to [Kerri Panchuk](#) ^[5].

Article printed from HousingWire: <http://www.housingwire.com>

URL to article: <http://www.housingwire.com/2011/03/15/gses-inflated-subprime-balloon-before-it-popped-cato-institute>

URLs in this post:

[1] C: <http://finance.yahoo.com/q?s=C>

[2] JPM: <http://finance.yahoo.com/q?s=JPM>

[3] :) and Goldman Sachs (GS: <http://finance.yahoo.com/q?s=MS>)

[4] BAC: <http://finance.yahoo.com/q?s=BAC>

[5] Kerri Panchuk: <mailto:kpanchuk@housingwire.com>

Copyright © 2009 HousingWire. All rights reserved.