



GSE reform captures political attention

Mid-term election cycle brings housing reform into focus

By: Christina Mlynski - November 13, 2013

As Capitol Hill enters the mid-term election year, policymakers are scrambling to be the first to propose and pass legislation for housing reform to get one up on the competition, market experts cautioned Wednesday.

In Washington D.C., politics trumps all economic headwinds, especially when housing reform is on the table.

Five years after the crisis there was little activity to drive GSE reform, but as we approach an election cycle, both parties want to check off the box that they have done something for the mortgage finance system," explained Graham & Fisher managing director Josh Rosner.

Policymakers have thrown their cards on the table, offering a handful of legislative resolutions to combat government dominance in the mortgage finance system. However, many market participants find these proposals to be fundamentally flawed.

For instance, the Corker-Warner bill is being challenged for trying to put private capital at the center of the system to the extent that "private capital is at a point of attack."

"If you're going to do that, you're going to distort credit allocation because you're creating a large class of investors who are putting in money that's protected by the government so they won't care where their money is going," stated American Enterprise Institute resident fellow Alex Pollock.

He added, "That type of system will inevitably create an overexpansion of mortgage credit. It's a fundamentally flawed anti-democratic idea."

In May, Sen. Bob Corker, R-Tenn, created legislation that was constructed to reform the housing finance system, particularly winding down both Fannie Mae and Freddie Mac.

The proposal builds upon the issuer-based approach, which is associated with a financial institution guaranteeing principal and interest repayment to investors.

Mortgage analysts remain weary on the critical placement of government guarantee given that many other markets for long-term financing operate without a government guarantee.

What we really need to address is whether securitization needs to be recreated through a private label or a guaranteed sense," pointed out Cato Institute director of financial regulation studies Mark Calabria.

He added, "We aren't asking the right questions in GSE reform right now."

Interestingly, some experts noted that in a rush to seek a political solution to an economic problem, the market is handing the system over to too-big-to-fail institutions.

"It's ironic because Congress is basically replacing the GSEs with entities that are being tasked with the same purpose," Rosner stated.

He continued, "The central role of the banks would result in regional and community banks becoming third-party originators, pushing them out to the sidelines."

Overall, all experts agreed that the market cannot address housing reform by choosing between more government involvement or less government involvement — it has to involve reasonable economic policies.

"We need to frame housing reform, generate research and understanding of the market so that people know how much the special interests are sound opposed to public policies," concluded mortgage economist Arnold Kling.