Plans to reinvent housing finance laid out before House subcommittee

by JON PRIOR

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The House subcommittee on capital markets and the government-sponsored enterprises heard testimony Wednesday on plans to revamp the housing finance system, with most proposing to disassemble **Fannie Mae** and **Freddie Mac**.

Lawmakers were almost unanimous in their opening statements calling for a end to taxpayer bailouts of risky mortgage investments. Each plan they heard held slight resemblances of each other but ultimately agreed that the government needs to withdraw its role, making way for the private sector.

Mark Calbria, director of financial regulation studies at the **Cato Institute**, was up first, making the argument for moving Fannie Mae and Freddie Mac into receivership from conservatorship, which they entered into in September 2008. Receivership, Calbria said, would put losses on the shoulders of GSE debtholders rather than the taxpayer and would give the receiver more powers to wind down these companies. He pointed out that they would not end their charters but "clean" them and ready a new charter.

Anthony Randazzo, director of economic research at the **Reason Foundation**, said the bases for any reform would start with the "shut down" of Fannie and Freddie, according to his testimony.

Alex Pollock, resident fellow at the **American Enterprise Institute**, testified that granting perpetual charters to the GSEs was a "historical mistake," and suggested a five-year sunset charter for the two companies, having them expire in 2016.

Sarah Wartell, executive vice president at the **Center for American Progress** warned against immediately dissolving Fannie and Freddie as the private market is still waiting for clearer regulations and cleaner mortgage servicing practices before it returns to the secondary market.

Loan Limits

Nearly every proposal at the House hearing called for a reduction in the GSE loan limit, with only slight variations for how high they should be. Higher income households, Calbria said, are better able to bear the increase in mortgage costs if Fannie and Freddie go.

He suggested lowering the loan limit from the $729,750 currently to $500,000 by reducing it $50,000 each year with some flexibility for reversals. This, he said as did others in the hearing, would increase the size of the jumbo loan market and ease the private market back into the system.

Randazzo argued it should be lowered by 20% by the end of September, when the current loan limit is set to expire.

"This would be a small step towards creating more room for the private sector to engage the mortgage market, and it could be test case to see how far the jumbo market is able to expand in this economic climate," Randazzo said.

Pollock suggested reducing the loan limits by 3% or 5% per quarter with a review of the results in two years.

But Wartell warned that if the loan limit were to fall and the private market failed to provide capital for homes, credit would be more constrained than it already has been.

Will the 30-year FRM survive without GSEs?

The question came up during the hearing, asked pointedly by Rep. Maxine Waters (D-Calif.). Wartell made the argument that without the government backing of these securities, low- to middle-income borrowers would essentially be priced out of the market as the 30-year fixed-rate mortgage became harder to get.

Randazzo suggested in his testimony that the down payment requirement for mortgage bought by whatever replaces the GSEs be gradually increased to 20% by 2014. Pollock said he couldn't know if the 30-year FRM would disappear "until this economic experiment is conducted."

Calabria said that the qualified residential mortgage standard regulators are currently working on should be applied to the GSEs or their replacements, requiring a minimum down payment of 10%.

Rep. Jeb Hensarling (R-TX) pointed out that 30-year FRMs did exist in markets where Fannie and Freddie did not do business, but several lawmakers addressed concerns that investors would not be willing to take the risk without government backing. **PIMCO**'s Will Gross recently said that without this backstop, he would not invest in securities containing mortgages where the borrower did not put at least 30% down.

Will they stay or will they go?

Members of the panel touched a variety of different issues from **Federal Housing Administration** reform to a proposal for a **Government Accountability Office** review of the mortgage representation and warranties settlements.

Rep. Barney Frank (D-Mass.) told Bloomberg Television after the hearing "by the end of the year, we should have an agreement" on the future of Fannie and Freddie.

All panelists conceded that a smaller government role in the mortgage market is inevitable and needed.

Brian O'Reilly, president of the financial advisory firm **Collingwood Group**, and former director at Fannie Mae, told HousingWire in reaction to the hearing that both of the GSEs need to go.

"Any additional time, money or energy spent on reforming Fannie or Freddie is wasted time, money and energy. They are failed institutions and should be resolved (meaning liquidated) in an orderly manner," O'Reilly said.

Anthony Sanders, a scholar at the Mercatus Center at **George Mason University** and a real estate finance professor, said the GSE's did not help borrowers save that much on their mortgage, and their continued presence in the market is doing more harm than good.

"Fannie and Freddie lowered mortgage rates by about 30 basis points at most. And they tried increasing homeownership rates to unsustainable levels while costing taxpayers hundreds of billions of dollars," Sanders told HousingWire. "So, will we miss Fannie and Freddie? No, in the same way that we don't miss gas rationing."

Write to Jon Prior.