Obama Administration Unveils Fannie, Freddie Proposals to Much Debate

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More than two years after the housing bubble collapsed and the financial crisis struck, one debate that looms large in Washington is about to be re-ignited Friday morning: What can and should be done about the housing giants Fannie Mae and Freddie Mac?

The debate has roiled continuously for years between Republicans and Democrats. But you can expect plenty of arguments once again on Friday when the Obama administration releases a so-called "white paper" outlining at least three ideas for how the government should deal with Fannie and Freddie. The two companies are semi-private, semi-public entities that have been pivotal in providing credit and liquidity to a battered housing market. Together they have a combined portfolio of more than $1.5 trillion in mortgages.

At the heart of the debate for politicians, lenders, consumer groups -- and yes, most importantly, homebuyers -- lie these fundamental questions: Should the government help back the mortgage-lending market? To what extent? And if the government's role shrinks substantially, will that lead to a housing market with lower assets, higher costs and a change in the way mortgages are created in the U.S.?

During the battle over financial reform on Capitol Hill last year, the Obama administration promised to offer its own proposals this year on how to either reform the two quasi-governmental entities, reduce their role or potentially eliminate them altogether.

Now, the outline of ideas being released Friday morning will surely leave many unsatisfied.

White House and Treasury officials believe most of the proposals outlined in the document largely reflect one common reality: "I think most people will agree that we want more private financing in the mortgage market and more equity in the game than we have had," a senior administration official told the NewsHour on Thursday.

"We're looking for a transition path so that the private market can go back to a bigger role once again," the official said. "Few people want to rip off the Band-Aid immediately" by phasing out Fannie and Freddie sooner.

It should be noted that some experts like American Enterprise Institute scholar Peter Wallison say it would be too difficult to phase out Fannie or Freddie out now because of a fragile housing market, **but say we should do so in next few years.**

There's no doubt that Fannie (founded in 1938) and Freddie (which came about later) have played an ever-growing role in the housing market. The two government-sponsored enterprises (or GSEs) helped foster the market for affordable housing by either owning, selling or backing mortgages with what was widely assumed to be the guarantee of the government.

But as the market for sub-prime mortgages grew, Fannie and Freddie lowered their standards to capture their share of the mortgages. Why the GSEs pursued that course is also a matter of dispute. (**New York Times columnist Joe Nocera has made the case that the two entities followed Wall Street down a wrong path**, **Peter Wallison and others say it was their mission to expand home ownership which was the real problem**.)

When the housing bubble popped, the government put them into conservatorship, dropping more than $150 billion in taxpayer money to stabilize them. The taxpayers now own most of these entities. Moreover, their role has grown: Estimates say that Fannie and Freddie help back three out of every four new mortgages over the past couple of years. (**Reuters has a handy summary of their history and of some of the debate surrounding that history here**).

While the administration will punt on making any recommendations -- **which is frustrating to Republicans and some say is a political move to put the pressure on Republicans for their own plan** -- the white paper is expected to lay out a number of options for Fannie and Freddie, including these:

- A much more limited role for the GSEs and a more limited government guarantee in backing mortgages, but with flexibility. That role could potentially expand in helping stabilize the market and ensuring mortgage securitization at moments of crisis or when huge housing slump (like the present one) occurs.
- A less dramatic reduction of the government's role in guaranteeing mortgages
- Reducing the size of loans that Fannie and Freddie can back. Currently they are as high as $729,000 and they will drop to $625,000 next fall unless Congress acts.
- Requiring homeowners, lenders, banks to put more skin into the game. That could include increasing insurance premiums charged by Fannie and Freddie. Or other fees passed onto home buyers.

- Eliminating the two GSEs entirely, perhaps over four or five years to give the market time to recover and adjust.

Many argue there's a need for something like a Fannie and Freddie going forward.

"They provided capital that kept housing flowing. Those mortgages carried an implicit goverment guarantee that was not paid for and no one wants to return to that, " says Sarah Wartell, who worked in HUD during the Clinton administration and is now at the Center for American Progress. "We need to create a better system that protects the taxpayer and is more transparent and to the extent that anyone is giving a guarantee, they are paid a premium for taking on that obligation."

While a number of conservative experts say they know Fannie and Freddie can't be shut down tomorrow, they think it's important to eliminate them.

Count Mark Calabria of the Cato Institute among those voices. He worked at the Senate Committee on Banking, Housing and Urban Affairs.

"I would see our mortgage market ultimately being smaller, which I think is a good thing," Calabria told the NewsHour.

"To me a reasonable transition period is five to six years," he continued. "But I think you need to put a credible process in place to push along reform. We can't live with the promise to fix it someday in the future, there have to be things in place that have a path forward."

And some consumer groups are worried about where the whole direction of the debate is going. Could it lead to the end of the 30-year fixed-rate mortgage eventually? Would mortgage rates be higher, home prices lower? Even if the changes are not that dramatic, small shifts in interest rates, for example, could have a significant effect.

"I think if the government gets out of the business of housing, we will see a dramatic reduction in mortgage lending and homeownership that I think would be disastrous for our economy," said John Taylor, president of the National Community Reinvestment Coalition.

"What has made the system work well was the presence of government guarantees," he says. "What made it work poorly was actually the private sector opening the pipeline for unscrupulous and unsustainable loans, followed by the GSEs mimicking the free market. So it wasn't the government that led us here, it was the private sector. We are about to shift responsibility to the to the private sector."

The debate will continue for many months to come. What's not clear is whether Congress and the administration will take any concrete actions before the year is out.