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# Reforming The Government's Housing Finance System Without Fixing It

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On Tuesday the Senate Banking Committee will be voting on legislation to reform our current system of government-sponsored enterprises (or GSEs) in the housing market and their role in helping to finance home mortgages, with the full Senate possibly voting as well later this year. And not a moment too soon: Some sort of reform is long overdue. Fannie Mae and Freddie Mac, the aforementioned GSEs got away with a multitude of sins before the financial crisis, most of which were excused because they were ostensibly done to further the dubious goal of increasing home ownership. Home ownership became the mother's milk of the political class on both sides of the aisle.

These days few people pretend that increasing home ownership is an unambiguous good. The financial crisis and the trillion dollar deficits in its aftermath were the most obvious cost of this ruinous policy goal.

However, the legislative language that will be put to a vote tomorrow doesn't extricate the government from the housing finance mess it created. By putting over $5 trillion of debt owned by Fannie Mae and Freddie Mac on the Treasury's balance sheet, it opens the government up to another massive liability. In the event of another recession or housing downturn, the government may find itself just as exposed as it was in 2008.

First, a brief primer on Fannie and Freddie: they do not make home mortgages, but rather buy mortgages from banks, package them together, and then sell them to interested investors.

When done correctly it is a business that can be immensely profitable, especially when done by an entity that enjoys low borrowing costs because of the backing (whether implicit or explicit) of the federal government.

And it was very profitable for a long time for the two, but the pressure from shareholders to keep returning ever-growing profits (especially in the face of higher interest rates) and from Congress to do more to help low-income Americans buy homes eventually led to the two entities buying (and keeping) low-quality, high-yield mortgages and leveraging them up to goose their returns.

This strategy backfired spectacularly, and the two firms essentially went bust.

In the midst of the great recession the government put them into a conservatorship, assumed ownership of just under 80 percent of each, and recapitalized them to the tune of $186 billion.

As the economy and home prices started bouncing back, so did their profits, each dime of which the Treasury has swept into its coffers. As of today the government has recouped its direct equity investment into the two.

The legislation being considered by the Senate Banking Committee would essentially wind down Fannie Mae and Freddie Mac as well as their regulator, replacing them with reasonable facsimiles unburdened by the sins of their predecessors.

The new mortgage finance entities would be free of debt because those debts would be effectively assumed by the federal government. Fannie Mae and Freddie Mac currently have a little over $5 trillion of debt in their collective portfolios that would be effectively handed over to Treasury under the terms of this legislation.

This does not necessarily mean that the federal government will get a lot poorer as a result of the legislation: If the economy keeps its slow-but-steady pace and the housing market resists another price decline in the near future, the Treasury will most likely be able to wind down the debt while avoiding any major problems.

However, another recession or just another decline in housing prices could wreak havoc with that debt, leaving the federal government holding the bag. The copasetic conditions that led the Treasury to make a couple hundred billion dollars from Fannie and Freddie the last three years could be wiped away in short order.

Congress has accomplished little over the last year and it's doubtful that it has the ability or inclination to reform our mortgage finance system in the near future either. But if it were serious about fixing our supremely screwed up system it should begin by not merely throwing the debts of the GSEs onto the government's balance sheet. It could also do more to shrink the two while simultaneously looking more towards the private sector to bring more mortgage financing to the table. After years of Fannie and Freddie effectively being the only game in town, a little true competition would be good for consumers — and for other banks that might be interested in breaking into the home mortgage business.

Government too often makes reforms to fix the last crisis while failing to think creatively about the potential risks that might trigger the next one. It's a mistake that Congress is in danger of making again when it comes to housing finance.

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