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Garrett urged to keep government in housing

by JON PRIOR

December 7th, 2011

Housing industry trade groups will press Rep. Scott Garrett, R-N.J., Wednesday to include a government role in his future housing finance proposal.

Garrett introduced components of his proposal in October, which includes clearer guidelines and disclosures for a mortgage market fully funded by private investors. He has not introduced legislation yet through the capital markets subcommittee he chairs. Instead, he held one hearing in November where **Federal Housing Finance Agency** Acting Director Edward DeMarco called it "thoughtful" but wanted assurances taxpayers would be completely protected in times of crises.

In preparation for a second hearing scheduled Wednesday, Garrett circulated the proposal to housing industry trade groups for their thoughts.

According their collective written testimony, much was lauded in the Garrett proposal. Each described a market starved of private capital, but most on the panel added there is a necessary involvement needed from the government too, an unsavory notion to conservatives.

"The importance of housing whether owner-occupied or rental, to the nation's economic and social fabric warrants a federal government role in promoting liquidity and stability in the core mortgage market," according to testimony from **Mortgage Bankers Association** CEO David Stevens. A proposal from the MBA would include an explicit guarantee on a class of mortgage-backed securities paid for through fees.

Tom Salomone, representing the **National Association of Realtors**, didn't want a repeat of the credit crunch in 2007, when private funding for mortgages froze. He, too, asked for some sort government role in times of crises.

"A full shut-down of the conventional conforming portion of the secondary mortgage marketplace, means there would be very limited or no funding for middle class homeowners or homebuyers, which would be devastating to the national economy—possibly causing a catastrophic collapse," Salomone said in written testimony.

While Chris Katopis, executive director for the **Association of Mortgage Investors**, said the trade group would not directly back the Garrett proposal, though he did applaud much of the clarity it grants, specifically for representation and warranty language. To him, the government still has a role in the future structure, albeit a supporting one.

"The government has a role – not through the heavy-hand of big government, but rather, the light touch of a prudent standard-setter and facilitator," according to his written testimony. "With appropriate standards and rights for the holders of asset-backed securities, securitization would achieve the goals sought by many – the more efficient funding of capital markets, lessening volatility, and the resulting better economic activity."

Future of the 30-year FRM

Most are concerned with the future of the 30-year fixed-rate mortgage if the future market is completely turned over to private investors.

In the early 1970s, Stevens said, mortgage lenders discovered investors were willing the bear the prepayment risk associated with the 30-year FRM as interest rates rose and fell. But only as long as they were protected from the credit risk.

"From that point to today, with a few exceptions, most investors either did not have the capacity or the willingness to take on the credit risk, particularly given the uncertainty involved with systemic credit events such as the one we just experienced," Stevens said.

Salomone with NAR said American borrowers enjoy the long-term loan precisely because the U.S. backs the mortgage market more than any other country. He cited research from economist Susan Woodward that finds the 30-year FRM would disappear without the backstop.

"There is no evidence that a long-term fixed-rate residential mortgage loan would ever arise spontaneously without government urging," Salomone said.

While other economists question the need to defend the 30-year FRM at all costs lenders and real estate agents on the ground see enough demand for it from their clients to warrant such strong language in protecting the product.

The next step is needed

Not every panelist wanted a government role. Some testimony on the Garrett proposal came in direct contrast with these very trade groups some consider responsible for lobbying Congress to support overreaching homeownership goals.

Mark Fleming, chief economist for the analytics firm **CoreLogic** (CLGX: 13.73 0.00%) said the government's role should limited only to setting guideposts, not risk management.

"Similar governmental initiatives introduced now or in the future would be unnecessarily burdensome and redundant, directing resources away from rapidly advancing private enterprise risk management efforts to improve transparency across the RMBS and capital markets," Fleming said in written testimony. "We support Congressman Garrett's PMMIA as currently proposed – and subsequently refined – to the extent that it does not call for any such additional governmental action."

Mark Calabria, director of financial studies at the **Cato Institute**, said a fully funded private mortgage market is very possible even though it may not be able to rely on the secondary market as it once did.

"While I believe we cannot completely replace our current system solely with private label securities, for instance returning to a structure based more on deposit-funded portfolio lending should be key to any reform, the draft legislation before the Committee represents an important step in the process," Calabria said in written testimony. "If lenders or borrowers wish to have 'insurance' against extreme market events, then they should purchase such insurance on the open market like any other good."

All agreed action is needed quickly. Fannie and Freddie have lingered in conservatorship for more than three years with only three private securitizations since – all from **Redwood Trust** (RWT: 10.70 +1.61%) and only for higher-priced homes in the jumbo market.

The GSEs currently owe more than $150 billion in bailouts and counting, however, they along with the **Federal Housing Administration**, fund 95% of the mortgage market still. And yet, no proposal has even made it out of subcommittee, leaving most to believe a resolution will have to wait until after the November 2012 elections.

"While a gradual transition to a new housing finance system is desirable, there are strong reasons to lay out a clearly defined future for mortgage finance as soon as possible," Stevens said in written testimony. "The uncertainty over the future policy environment is deterring the recovery by inhibiting the ability of businesses and investors to plan and move forward."

"Quite frankly there should be no higher priority for this subcommittee than the reform of our broken mortgage finance system," Calabria said in his testimony. "Continued delay adds to market uncertainty and hobbles the development of private market solutions. Delay also adds to the increasing taxpayer cost of bailing out our mortgage finance system."