



Meet Freddie Mic

Fannie and Freddie's cousin, Johnson-Crapo's creation, smells.

By John Berlau

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A corollary to Shakespeare's *Romeo and Juliet* adage, "A rose by any other name would smell as sweet," is that "garbage by any other name would smell as awful."

The latter seems *apropos* to the "reform" of the government-sponsored housing enterprises Fannie Mae and Freddie Mac introduced by the Senators Tim Johnson (D-S.D.), and Mike Crapo (R-Idaho), the chairman and ranking member of the Senate Banking Committee. The bill was set to be marked up April 29, but was delayed after opposition garnered from many quarters. Now after completely ignoring conservative concerns and [pandering to lefties](#) like Sen. Elizabeth Warren (D-Mass.), Crapo and Johnson will likely try again this Thursday to get a bare majority to vote the bill out of committee.

A [letter](#) last month coordinated by the Competitive Enterprise Institute and signed by 26 conservative and free-market groups declares that Johnson-Crapo "does not constitute real reform," but an expansion of the type of government intervention that fueled the housing crisis in the first place.

While the media often characterizes this plan as "ending" Fannie and Freddie, most of their functions would simply be transferred to a new giant government entity, the Federal Mortgage Insurance Corporation, or what we could call "Freddie Mic." Not only would the government's role in subsidizing and micromanaging housing not be reduced, in some ways it would be substantially increased.

Further, the [legislation](#) would create an *explicit* taxpayer guarantee of the government-sponsored enterprises' \$5.6 trillion in debt, and the National Housing Trust Fund (a political slush fund for "housing advocacy" groups on the Left — such as the now-defunct ACORN — until it was closed due to Fannie and Freddie's financial woes) would be reopened and parked in the new Freddie Mic.

Worst of all, and sending the worst possible signal to potential private sector investors, Fannie and Freddie's shareholders would be wiped out permanently under the bill's Section 604.

Fannie was created as a government agency in 1938 and spun off as a government-sponsored enterprise (GSE) in 1968. Freddie was created as a sister GSE two years later. Even though they

had private shareholders, they always retained government privileges: They were exempt from state and local taxes, and, importantly, each had a \$2 billion line of credit with the U.S. Treasury.

Back in 2000, the Competitive Enterprise Institute's Founder Fred Smith predicted in his [testimony](#) before Congress that "as long as the [government] pipeline is there, it's very expandable.... It could be \$200 billion tomorrow."

He underestimated the ultimate tab to taxpayers for the bailout orchestrated by the Bush administration, which put the GSEs under conservatorship at the height of the financial crisis in 2008. While the Obama administration [estimates](#) the cost at \$188 billion, the Congressional Budget Office's "fair value" accounting [puts it](#) at \$317 billion.

But the real cost to taxpayers came from Fannie and Freddie's role in partnering with banks in issuing new subprime mortgages. As documented in the groundbreaking book [Reckless Endangerment](#), co-authored by *New York Times* Pulitzer-winning business columnist Gretchen Morgenson and financial analyst Joshua Rosner, the GSEs had key roles in providing invaluable assistance to bad actors in the private sector, including the notorious Countrywide Financial.

The American Enterprise Institute's Peter Wallison [opined](#) in the *Wall Street Journal* that in September 2008, "half of all mortgages — 28 million — were subprime or otherwise risky and low-quality," and of these, "74 percent were on the books of government agencies, principally the GSEs."

The Johnson-Crapo "reform" mostly just shifts these books around. Like an earlier bill drafted by Sens. Bob Corker (R-Tenn.) and Mark Warner (D-Va.), the plan replaces the GSEs with a government-backed mortgage insurer with political appointees.

Much is made of how private owners will take at least 10 percent of the loss on mortgage-backed securities Freddie Mac insures. But that still leaves 90 percent to be absorbed by the government. As *Reckless Endangerment* co-author Rosner [has written](#), "Unfortunately, the bill replaces Fannie and Freddie with an untold number of new government-sponsored enterprises by handing a massive taxpayer backstop to the nation's largest banks."

The biggest beneficiaries may be big-government housing advocates, since the Housing Trust Fund the Johnson-Crapo plan creates within Freddie Mac bears a remarkable similarity to that which used to exist within the GSEs.

The trust fund lay dormant during the Ed DeMarco's recent financial management of the GSEs. However, former Rep. Mel Watt (D-N.C.), DeMarco's replacement as head of the Federal Housing Finance Agency, which oversees the GSEs, has pledged to restart it.

And now, the fact that a bipartisan "reform" plan gives the "trust fund" its blessing will only strengthen Watt's hand in bestowing this patronage.

Worse (smelling) still, the “reform” explicitly codifies the Obama administration’s policy of completely wiping out Fannie and Freddie’s private shareholders, including community banks, pension funds, and middle-class investors.

In August 2012, Treasury Secretary Tim Geithner secretly issued the “Third Amendment” to the GSE conservatorship in which all profits would be siphoned-off to the U.S. Treasury Department in perpetuity, even after the GSEs paid back what they owed to taxpayers. Section 604 of Johnson-Crapo reiterates that these “shall not be amended, restated, or otherwise changed.”

Is this any way to attract new private investment? As Ike Brannon and Mark Calabria write in a new [paper](#) for the Cato Institute, “If we hope to rebuild our mortgage finance system on a foundation of private capital, then property and contractual rights must be respected.”

The best option to mitigate the risk posed by the GSEs to taxpayers and the economy is an orderly liquidation of their assets, with no government-backed entity to replace them.

As CEI’s Smith urged Congress in 2000 — to mostly deaf ears — policymakers should “develop a divestiture or breakup plan for Fannie and Freddie.” And in such a plan, as in traditional bankruptcies, the rights of both taxpayers and private investors should be sacrosanct.