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Mel Watt's plan to loosen mortgage credit will shape housing finance for years

By Joseph Lawler

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Despite being a new officeholder of a relatively obscure federal agency, Mel Watt drew a strong reaction for his speech Tuesday by signaling that the federal government will increase its role in helping more Americans buy houses.

For now, credit standards for home loans remain tight. But Watt's speech also sketched out a greater long-term role for the bailed- out mortgage businesses Fannie Mae and Freddie Mac.

For Republicans, it was the moment they had feared when, for months, they blocked President Obama's nomination of the former North Carolina Democratic congressman to his current post as director of the Federal Housing Finance Agency. As the conservator - - the government steward - - for Fannie and Freddie, the FHFA has massive influence over the mortgage market.

Watt began his speech noting "certain changes in focus" from the plans laid out by his fiscally conservative predecessor Ed DeMarco, and then outlined a number of plans to loosen the terms that Fannie and Freddie require for the loans they insure. The two government- sponsored enterprises buy loans from lenders and package them into insured securities, with the purpose of increasing liquidity in the mortgage markets.

The immediate reaction to Watt's speech was to raise concerns that his actions would inflate a new housing bubble, and it drew strong condemnations from right-of-center analysts, such as the Cato Institute'sMark Calabria:

Americans may understandably be concerned about the standards Fannie and Freddie require for the loans they guarantee -- the two did receive $188 billion in bailout funds after risking trillions on bad loans.

The background, though, is that mortgage credit remains tight.

That's partly because the FHFA, under DeMarco, took steps to tighten the terms required by Fannie and Freddie, including by raising the fees the two GSEs charge to guarantee loans. The

GSEs are dominant in the secondary mortgage market, backing roughly two- thirds of new loans in recent years.

This chart from Black Knight Financial Services, an industry data company, shows that both the GSEs and the overall market are requiring higher average credit scores for loans than they did before the housing bubble began inflating:

The Federal Reserve's survey of loan officers shows that they tightened terms for mortgages drastically during the crisis, and haven't significantly eased them since (and even have been tightening conditions again recently):