Four Ways to Start Fixing Fannie And Freddie

MORTGAGES, HOUSING, REAL ESTATE, CREDIT, LOANS, LENDING, ECONOMY, RECESSION, GOVERNMENT, FORECLOSURES, CONSUMERS, FANNIE MAE, FREDDIE MAC

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CNBC.com | 13 May 2010 | 11:58 AM ET

With major housing finance reform now unlikely until 2011, there's little that can be done to stop the massive losses at mortgage giants **Fannie Mae** and **Freddie Mac** , say analysts.

But there are some small fixes can be made before their future shape and size—or even continued existence—is determined.

1. Make A Timeline

Analysts say policymakers need a detailed time line with a hard deadline to avoid anymore postponement of the hard choices and difficult solutions needed to deal with a financial time bomb that has been ticking since the summer of 2008.

Fannie and Freddie were taken over by the government in September 2008 after the housing market imploded and the mortgages and mortgage-backed securities they held as collateral for their financing operations soured.

Since then the government has supplied about $125 billion in taxpayer funds to keep the institutions operating and the mortgage market functioning. The amount of financial aid is certain to rise, analysts say, and could wind up costing taxpayers $200-$400 billion.

Despite those mounting losses, neither the Obama administration nor the Democrat-controlled Congress have been willing to include Fannie and Freddie in a sweeping financial reform plan. Just this week, Congress voted to study the problem rather than move on it, putting a final resolution years off.

Still, analysts argue that some steps can be taken now. And the first is to list what the steps are and when they can be made.

"There's a giant dead-weight loss that can only be covered in one or two ways," says Alex Pollock of the American Enterprise Institute and a former CEO of the Federal Home Loan Bank of Chicago. "Either the debtholders take a loss or the taxpayers do."

2. Put Them on the Budget

That choice will be much more obvious, some argue, if Washington puts the balance sheets of the two firms on the federal budget.

"The loss should be accounted for," says Mar Calabria of the Cato Institute, a libertarian think tank, and a former senior Senate aide. "You're not changing the structure but you are giving some transparency."

Others worry that such a move could backfire.

"It effectively brings them further into the government fold and represents a new and more explicit nationalization," says independent bank analyst, Bert Ely.

A change in the firms' budget status might prompt swifter government action beyond what has happened to date. To date the only concrete step is an item in the financial reform regulation legislation calling for a study of the firms by Jan. 31, 2011, a year the Obama administration says it will offer its recommendations.

3. Lower Conforming Loans

One simple fix or experiment would be to reduce the ceiling for conforming or conventional loans, which qualify a borrower for federal guarantees. The current level for a single-family house --$417,000-- is double that of 1996. In high cost areas, the level is higher, reaching a maximum of almost $730,000.

That limit could be based on the median price of a home in a given metropolitan area,

"Start ratcheting down the conforming loan limit, year by year," says Pollock. "Guess what? Mortgages will be slightly more expensive but why would we want to subsidize mortgages? All you do is succeed in making housing prices higher."

Proponents say the change would take Fannie and Freddie out of more markets, leaving it strictly up to the private sector.

"It's kind of a back door way of trying to force them out of the business," says Ely.

Yet, even basic proposals such as this, touch a lot of nerves and trigger somewhat ideological debates.

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"If we're going to experiment with the housing market let's experiment with the high end," says Calabria. "There's no rationale to passing on a subsidy" to higher income people.

"There's no wisdom in that," counters Melissa Cohn, founder and CEO of Manhattan Mortgage in New York City. "We're trying to support the value of real estate."

Whether it is small fixes or big ones, much of the current opposition in political, business and policy circles turns on how anything might endanger the fragile nature of the real estate recovery.

"I think transition measures have to be carefully designed," says David Min, associate director for financial market policy at the Center for American Progress. "The goal in the short-term should be to preserve the housing market so we don't have a double dip. And drastic change needs to be implemented slowly and only upon the re-emergence of private sector lending."

Skeptics say that's helped make a big problem even bigger.

At this point, some 96 percent of all U.S. residential mortgages are backed by the federal government. Fannie and Freddie are essentially embedded in the economy because they own or guarantee $5.5 trillion in mortgage debt, half the current market.

4. Better Lending Practices

Other small steps can be taken from a further tightening in lending standards to requiring larger down payments, particularly in the case of FHA loans.

"I think that's absolutely reasonable," says Cohn, the broker. "I think people need to have skin the game."

At this point, all agree that Uncle Sam can no longer afford to run the game and that Fannie and Freddie need to be made much smaller and more narrowly-focused government entities or essentially privatized through an orderly and gradual sale of their assets and assumption of debt.

"The fundamental problem is that there isn't any fix for them other than their ultimate dissolution," says Ely.

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