MORTGAGE PROFESSIONAL AMERICA

What setting Fannie and Freddie free could mean for the bond market

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It sounds positively heretical to some quarters, but proponents argue that deregulating Fannie Mae and Freddie Mac could help the Trump administration realize solid gains in its bid for housing reform.

Fannie and Freddie losses have reached $150 billion and firms such as Paulson & Co and Blackstone Group want the industry and the government to work together to stem the financial hemorrhage.

The two firms are among those who sponsored the Moelis & Co blueprint, a proposal that calls for the property sector to raise tens of billions of dollars in capital for mortgage-finance companies, while also limiting the use of federal funds to offset Fannie and Freddie's losses.

However, the blueprint is spooking investors who believe it could wreak havoc with the mortgage bond market.

Bloomberg reports that investors currently consider Fannie and Freddie packaged mortgages as guaranteed by the US government partly because they are under federal control. The report said that some investors are against the idea because limiting taxpayer rescue funds will release Fannie and Freddie to private shareholders like Paulson. This could in turn upend the $5 trillion market for the bonds they issue and hurt the common homebuyer, whose low interest rates are hinged on the demand for mortgage securities.

"I don't think you could sell virtually any of this debt overseas if it wasn't government guaranteed," Scott Simon, who managed multi-billion dollar mortgage backed securities for Pacific Investment Management Co, told Bloomberg.

Paulson is hoping the Trump administration would consider the plan as an instrument for helping meet its home financing objectives.

"The key to protecting taxpayers and limiting the amount of a government backstop is to build sufficient private capital. This is what the Moelis blue print does," the firm said in a statement. "The unintended consequences of putting into place a full mortgage-backed guarantee are enormous," Moelis senior advisor Landon Parsons said at a Cato Institute event last week.

He said that mortgage-bond investors want a full guarantee to get better capital treatment on Fannie and Freddie securities, but that such a guarantee could increase rates on other kinds of mortgages.

However, the Trump administration remains equivocal on the matter.

Treasury counselor Craig Phillips said at an Urban Institute forum that the administration believes the government should no longer extend implicit guarantees to Fannie and Freddie. Rather, he said, government should explicitly guarantee mortgage bonds. Undertaking the task would be difficult without legislation.

"An explicit guarantee would be good for mortgage investors and homeowners," Invesco senior portfolio manager Brian Norris said. He said that a limited backstop would not be enough for most investors, and an unlimited guarantee would help borrowers by driving down mortgage rates.