Supporting a Bipartisan Fix for Fannie and Freddie.docx

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Is There a Bipartisan Fix for Fannie and Freddie?

It is welcome news to hear that Senators Corker (R-TN) and Warner (D-VA) are looking to craft a bipartisan solution to the problem of Fannie Mae and Freddie Mac. The two massive mortgage companies have been in conservatorship since 2008 when they were on the verge of failing. At that time, nobody, just nobody, believed that they would still be in conservatorship ten years later.

But here we are. Resolving this situation is of great importance to the financial well-being of the nation. These two companies guarantee trillions of dollars worth of mortgages and operate like black boxes, run by employees who don’t have a clear mission from their multiple masters in government. This is the recipe for some kind of crisis. Maybe they will not underwrite their mortgage-backed securities properly. Maybe they will undertake a risky hedging strategy. We just don’t know, but there is reason to think that gargantuan organizations that have been in limbo for ten years may have developed all sorts of operational pathologies.

There have been a couple of serious attempts in the Senate to craft a long-term solution to this problem, but it was not a high priority for the Obama Administration and does not yet appear to be a high priority for the Trump Administration. Deep ideological divisions over the appropriate role of the government in the mortgage have also stymied progress on reform.

Congress member Hensarling (R-TX), the Chair of the House Financial Services Committee, leads a faction that wants to dramatically reduce the role of the government in the mortgage market. Senator Warren (D-MA) leads a faction that wants to ensure that the government plays an active role in making homeownership, and housing more generally, more affordable to low- and moderate-income households. At this point, it is not clear whether a sufficiently broad coalition could be cobbled together to overcome the opposition to a compromise at the two ends of the spectrum.

2017 presents an opportunity to push reform forward, however. The terms of the conservatorship were changed in 2012 to require that the Fannie and Freddie reduce their capital cushion to zero by the end of this year. That means that if Fannie or Freddie has even one bad quarter and suffers losses, something that is bound to happen sooner or later, they would technically require a bailout from Treasury. Now, such a bailout would not be such a terrible thing from a policy perspective as Fannie and Freddie have paid tens of billions of dollars more to the Treasury than they received in the bailout. But politically, a second bailout of Fannie or Freddie would be toxic for those who authorize it.

Some are arguing that we should kick the can down the housing finance reform road once again, by allowing Fannie and Freddie to retain some of their capital to protect them from such a scenario. But Senators Corker and Warner seem to want to use the December 31st, 2017 end date to focus minds in Congress. They, along with some other colleagues, have warned Fannie and Freddie’s conservator, Federal Housing Finance Agency Director Watt, not to increase the
capital cushion for the two companies. They claim that it is Congress’ prerogative to make this call.

The conventional wisdom is that the stars have not aligned to make housing finance reform politically viable in the short term. The conventional wisdom is probably right because the housing finance system is working well enough for now. Mortgage rates are very low and while access to credit is a bit tight, it is not so tight that it is making headlines. So perhaps Senators Corker and Warner are right to use the fear factor of future bailouts as a goad to action.

Housing finance reform requires statesmanship because there are no short-term gains that will accrue to the politicians that lead it. And the long-term gains will be very diffuse – nobody will praise them for the crises that were averted by their actions to create a housing finance system fit for the 21st century. But this work is of great importance and far-thinking leaders on both sides of the aisle should support a solution that takes Fannie and Freddie out of the limbo of conservatorship. It will require compromise, an acceptance of the fact that the perfect is the enemy of the good. But if compromise is reached, it may help to avoid another catastrophe that will be measured in the hundreds of billions of dollars. And it will ensure that we have a mortgage market that meets the needs of America’s families.

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