Are The Stars Aligning For Fannie And Freddie Reform?

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By David Reiss
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There has been a lot of talk of the closed-door discussions in the Senate about a reform plan for Fannie Mae and Freddie Mac, the two mammoth housing finance government-sponsored enterprises. There has long been a bipartisan push to get the two entities out of their conservatorships with some kind of permanent reform plan in place, but the stars never aligned properly. There was resistance on the right because of a concern about the increasing nationalization of the mortgage market and there was resistance on the left because of a concern that housing affordability would be unsupported in a new system. It looks like the leader of that right wing, House Financial Services Committee Chairman Jeb Hensarling, R-Texas, has indicated that he is willing to compromise in order to create a "sustainable housing finance system." The question now is whether those on the left are also willing to compromise in order to put that system on a firm footing for the 21st century.

In a speech at the National Association of Realtors, Hensarling set forth a set of principles that he would be guided by:

- Fannie Mae and Freddie Mac must be wound down and their charters repealed;
- Securitizers need strong bank-like capital and community financial institutions must be able to compete on a level playing field;
- Any new government affordable housing program needs to at least be on budget, be results-based and target actual homebuyers for the purpose of buying a home they can actually afford to keep;
- The Federal Housing Administration must return to its traditional role of serving the first-time homebuyer and low- and moderate-income individuals.

I am not yet sure that all of the stars are now aligned for Congress to pass a GSE reform bill. But Hensarling’s change of heart is a welcome development for those of us who worry about some kind of slow-moving train wreck in our housing finance system. That system has been in limbo for nearly a decade since Fannie and Freddie were placed in conservatorship, with no end in sight for so long. Ten years is an awfully long time for employees, regulators and other stakeholders to play it by ear in a
mortgage market measured in the trillions of dollars.

Even with a broad consensus on the need for (or even just the practical reality of) a federal role in housing finance, there are a lot of details that still need to be worked out. Should Fannie and Freddie be replaced with many mortgage-backed securities issuers whose securities are guaranteed by some arm of the federal government? Or should Fannie and Freddie become lender-owned mutual insurance entities with a government guarantee of the two companies? These are just two of the many options that have been proposed over the last 10 years.

Two housing finance reform leaders, Sens. Bob Corker, R-Tenn., and Mark Warner, D-Va., appear to favor some version of the former while Hensarling seems to favor the latter. And Hensarling stated his unequivocal opposition to some form of a “recap and release” plan, whereas Corker and Warner appear to be considering a plan that recapitalizes Fannie and Freddie and releases them back into private ownership, to the benefit of at least some of the companies’ shareholders. The bottom line is that there are still major differences among all of these important players, not to mention the competing concerns of Sen. Elizabeth Warren, D-Mass., and other progressives. Warren and her allies will seek to ensure that the federal housing system continues to support meaningful affordable housing initiatives for both homeowners and renters.

Hensarling made it clear that he does not favor a return to the status quo — he said that the hybrid GSE model "cannot be saved, it cannot be salvaged, it must not be resurrected, and needs to be scrapped." But Hensarling also made it clear that he will negotiate and compromise. This represents a true opening for a bipartisan bill. For everyone on the left and the right who are hoping to create a sustainable housing finance system for the 21st century, let’s hope that his willingness to compromise is widely shared in 2018.

I am now cautiously optimistic that Congress can find some common ground. With Hensarling on board, there is now broad support for a government role in the housing sector. There is also broad support for a housing finance infrastructure that does not favor large financial institutions over small ones. Spreading the risk of default to private investors — as Fannie and Freddie have been doing for some time now under the direction of their regulator — is also a positive development, one with many supporters. Risk sharing reduces the likelihood of a taxpayer bailout in all but the most extreme scenarios.

There are still some big sticking points. What should happen with the private investors in Fannie and Freddie? Will they own part of the new housing finance infrastructure? While the investors have allies in Congress, there does not seem to be a groundswell of support for them on the right or the left.

How much of a commitment should there be to affordable housing? Hensarling acknowledges that the Federal Housing Administration should serve first-time homebuyers and low- and moderate-income individuals, but he is silent as to how big a commitment that should be. Democrats are invested in generating significant resources for affordable housing construction and preservation through the Affordable Housing Trust Fund. Hensarling appears to accept this in principle, while cautioning that any “new government affordable housing program needs to at least be on budget, results based, and target actual homebuyers for the purpose of buying a home they can actually afford to keep.” Democrats can work with Hensarling’s principles, although the extent of the ultimate federal funding commitment will certainly be hotly contested between the parties.

My cautious optimism feels a whole lot better than the fatalism I have felt for many years about the fate
of our housing finance system. Let’s hope that soon departing Congressman Hensarling and Sen. Corker can help focus their colleagues on creating a housing finance system for the 21st century, one with broad enough support to survive the political winds that are buffeting so many other important policy areas today.

David Reiss is a professor at Brooklyn Law School and director of academic programs at the Center for Urban Business Entrepreneurship. He is also the editor of REFinBlog.com, which tracks developments in residential real estate finance.

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