Congressional Battle Looms over Administration's Plans for Fannie and Freddie

February 11, 2011 - Today, the Treasury Department released a long awaited report dealing with the future of Fannie Mae and Freddie Mac; the two quasi-government agencies responsible for guaranteeing a majority of American mortgages. The report details a scenario which will make it more difficult for borrowers to qualify for loans and which is sure to negatively impact housing prices in higher priced markets across the country. It also promises to draw the ire of members of congress on both sides of the aisle; although for very different reasons.

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There is no arguing that Fannie Mae and Freddie Mac made one bad lending decision after another for many years. Their irresponsible and reckless behavior forced the federal government to take over both companies and contributed significantly to the collapse in housing prices. The companies have cost taxpayers more than $150 Billion so far. By the time the housing crisis ends, that cost could more than double. At ACCESS, we've been talking about mismanagement in both firms for years.

Since the government takeover of both companies, there has been a simmering debate. One side of that debate says that it is time for the government to get out of home lending altogetherâ€¦ if for no other reason than to protect taxpayers. That home lending should be a private sector activity that has little government involvement.

The other side of that debate claims that if the government makes a sudden exit from home lending, housing prices will collapse and we could be in for another deep recessionâ€¦ not that we've ever exited the first one.

Treasury's proposal attempts to straddle that fence, insuring that neither side will like it.

The proposal would do a number of things. First, it would increase the amount of money that buyers have to put down when purchasing a house using a Fannie or Freddie backed loan. The minimum down payment would be increased to 10%. Second, it reduces the size of a conforming loan in high priced markets from the current $729,500 to $625,000. This is set to take place in October. And finally, it would allow mortgage fees to increase to help support a transfer of Fannie and Freddie portfolios to private investors. At the same time, it would wide down the operation of both organizations over the next five to seven years.

The chances that the proposal will be adopted in its present form are slim. Many Republicans want to see a much more rapid dismantling of both Fannie and Freddie, but doing so is likely to have an even larger impact on housing prices. That's not likely to get much support from homeowners.

Democrats and Republicans alike in higher priced housing market are unlikely to want to see the reduction of size in conforming loans. That change could cause prices to plummet overnight, and has the potential to significantly increase the number of people who owe more on their homes than they are actually worth. It is also likely to run into stiff voter opposition as the public becomes aware of the proposal and its ramifications.

Regardless of what happens here though, it is worth noting that the reason that Fannie and Freddie made so many bad decisions was impacted significantly by the actions of Congress and the FED; both of which actively encouraged their behavior and both of which continue to play an active role with these firms. At some point, the government needs to divest itself from both firms - preferably protecting taxpayer interests in the process. Without such a divestiture, it is highly likely that both Congress and the FED will continue to encourage Fannie and Freddie to make other poor decisions; leaving taxpayers on the hook for even more money.

byJim Malmberg
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