Dallas Rep. Jeb Hensarling wants Fannie Mae, FreddieMac gone

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WASHINGTON – For years, conservatives inveighed against government-backed mortgage firms Fannie Mae and Freddie Mac. The complaints began with their dominance of the market and ended with a warning that taxpayers would bail them out one day.

Now that critics have been proven right, they're on the spot to show they know what's best for the future. Among the questions: Should Fannie and Freddie be privatized? Abolished? And how would government support the housing market without them?

Led by Rep. Jeb Hensarling of Dallas, House Republicans say they're eager to curb government's involvement in the housing market, starting with eliminating Fannie and Freddie. Hensarling has proposed legislation to do just that within five years; his ideas are most likely to matter if Republicans recapture the House in November.

"I don't think they are needed," said Hensarling, a senior Republican on the House Financial Services Committee. "Why, when I look at other industrialized nations, do I see higher rates of homeownership and no ... [Fannie and Freddie]? I see lower rates of foreclosure. I don't see the compelling reason why we want them except that we've done it this way."

Fannie and Freddie were chartered by Congress and given a responsibility to support the housing market by buying and selling home loans packaged into securities. The firms later became publicly traded, shareholder-owned companies but never cut the cord with taxpayers – the federal government continued to implicitly guarantee their debt.

Experts say that peculiar structure provided an incentive for the government-sponsored enterprises, or GSEs, to make risky investments, including buying exotic mortgages for their own portfolios. The Bush administration seized the companies in 2008 as they suffered huge credit losses on portfolio investments and guarantees on mortgage-backed securities.

'Fundamental change'

The Obama administration, which by January must provide a plan for reforming the companies, says it's committed to "fundamental change" of housing finance. Lawmakers agree that reinventing Fannie and Freddie is high on their to-do list. But the subject was left out of the recent financial overhaul law known as Dodd-Frank.

"Almost everyone agrees we're going to do away with Fannie and Freddie," said former Dallas Mayor and U.S. Rep. Steve Bartlett, president of the Financial Services Roundtable, a lobbying organization that represents large banks and other financial companies. "The issue becomes, what do you replace it with?"

The other big question – one intertwined with the future of Fannie and Freddie – is how active a role should government play in the housing market?

Hensarling insists the government shouldn't guarantee most mortgage loans. But some economists and bank lobbyists say the 30-year fixed-rate loan isn't viable without special federal support.

"The 30-year fixed is probably the most sustainable mortgage we have," said Mark A. Willis, resident research fellow at the Furman Center for Real Estate & Urban Policy at New York University. "That would definitely be – if not jeopardized – extremely more expensive to get without the government guarantee."

Economists and other experts say the benefits of the current system could be preserved without risking huge losses for taxpayers.

Regulation would have to be strengthened, and Fannie and Freddie – or their successors – would be barred from buying risky loans for their own books. The government could provide "reinsurance" for the mortgage securities, but the entities that sell the securities would have to pay a special fee for the guarantee. Only conventional, well-documented loans would be eligible for the guarantee.

A 2006 study by Federal Reserve Board economists found that borrowing costs were lower by 7 basis points (0.07 of a percentage point) as a result of Fannie's and Freddie's activities. Ten years earlier, the Government Accountability Office estimated it was between 15 and 35 basis points.

Is cost warranted?

Hensarling says those benefits aren't enough to warrant the $150 billion that taxpayers have injected into the companies during the recent housing-market meltdown. He says he's not convinced that private lenders wouldn't offer 30-year fixed-rate loans without a federal guarantee.

"In some cases, it's a difference [on a loan] of between 6 percent and 5.92 percent," he said. "Is that really worth $150 billion?"

The Congressional Budget Office has estimated that the total cost to taxpayers for taking over the companies could reach $389 billion. Even so, some House Democrats have said there is no hurry to reform the companies because they have largely stopped purchasing risky mortgages since their near-collapse in 2008.

Hensarling said he thinks that Rep. Barney Frank, chairman of the Financial Services Committee, has "something in mind" for reform. A Financial Services subcommittee will hold a hearing on the subject Sept. 15.

"He has told me before that now that Dodd-Frank is passed, he'd like to do something on the GSEs," Hensarling said. "I take him at his word, but there isn't a whole lot of clock left here."

'We need to start'

Congress has fewer than four weeks of work left before lawmakers break to campaign for the November election. That isn't enough time to find compromises on the complex set of economic and political questions involved in reform, analysts say.

"It has taken too long to set up a plan and will take five years to transition where we go, but we need to start," said Ted Gayer, co-director of economic studies at the Brookings Institution. "Even with Republican control, it would be really hard to have a very quick transition to privatizing them, just given the state of the housing market."

Even among Republicans, there are important differences of opinion. Hensarling and some other conservative House lawmakers argue that the housing market can flourish without guaranteeing most mortgages. But other Republicans may be swayed by housing-industry lobbyists, who insist that a federal backstop is necessary.

"Most people in the market tell me you cannot have a functioning mortgage-backed securities market in the United States and a 30-year fixed-rate mortgage without some kind of a guarantee," Bartlett said. "The risk is too great and it's too big.”