

Confused About GSE Reform???

What Does The Housing Finance Reform Act (H.R. 1859) Actually Do?

Seen some conflicting information on the Campbell/Peters bill and just need the facts?

Here are three most frequently asked questions on H.R. 1859. Make your own decision.

1. Isn't this bill just recreating the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac again? It looks like you are just going to have 5 of them instead of two.

No. The whole point of this bill is to kill the old GSE system and replace it with something completely different that will provide stability for housing finance. The GSEs were/are monopoly entities formed by the government. The "associations" in H.R. 1859 will be entirely private entities and there will be at least 5 of them, but we frankly hope there will be dozens in order to create competition and spread the risk around. The existing GSEs can make mortgages, hold them in their portfolios, sell them and engage in all kinds of other businesses. In this bill, associations can only guarantee conforming mortgages and they cannot make or hold any mortgages themselves. The GSE's themselves were guaranteed by the federal government for dollar one of loss. The associations will not have any federal guarantee. The only federal guarantee will be on the mortgages and not the associations, and it will only kick in after the down payment, all capital in the entity, and all capital in the insurance fund is gone. The GSEs pay nothing for their federal guarantee, but the associations will pay a market rate to put a guarantee on a group of mortgages. In short, the GSEs were their own special entity and there was and is nothing like them. The associations in this bill will follow the model of public utilities (an electric company, for example) and the banking system. Remember that when you make a deposit in a bank, it is guaranteed by the FDIC. But, the capital requirements, limits, insurance fund and number of banks out there have made the system work even through the recent crisis.

2. How is the taxpayer protected? How do I know there won't be another bail-out like the current bail-out of the GSEs?

As mentioned above, H.R. 1859 is extremely different than the current GSE system. The fact that there will be many of these associations and that they are not themselves guaranteed by the government means that they can fail and, if they do, there will be no government money used to prop up the entities. In order for the taxpayers to be at risk, a group of mortgage portfolios would have to first decline enough to eat through the 20% down payment (more on that later). Then, the losses would have to eat through the entire substantial capital of the association, which would then have to be insolvent. If that occurs, the losses would still then have to eat through another layer of private capital, which is the insurance fund (again, similar to the FDIC) into which all of the associations pay. Even then, the government can ask the remaining associations to pay more into the insurance fund to top it up. Bottom line is that the amount of private capital and the control of these organizations will be such that a collapse like we had in 2008 would not trigger any taxpayer liability.

3. Why not let the GSEs wind down and then not replace them with anything? Why not rely on the private sector?

Without some support, the 30 year mortgage will go away. Investors will simply not make loans of that duration, with a fixed rate, and additionally take the 30 year risk that a homebuyer might not ever pay them back. If we were to wind down the GSEs without some viable replacement system, home loans would likely require 25% down or more and mortgage durations would fall to 15 years or less. This would easily trigger a 30% decline in housing prices as the payments for any home loan would rise dramatically. This decline would plunge the economy into a major recession/depression and greatly reduce the number of people able to own homes in the future. This is a disaster scenario which is completely avoidable. The government is making over 95% of all home loans right now through the GSEs and FHA. That alone is proof that there is no viable private market for such loans or it would be developing now.