

HOT TOPIC



Housing Trends: New Rules Could Revive Recovery

Fannie Mae and Freddie Mac are government-sponsored enterprises (GSEs) that purchase mortgages from lenders and package them into securities that are sold to investors. The two companies currently back about 60% of all U.S. mortgages, and their infrastructure has made the 30-year fixed-rate mortgage widely available to U.S. borrowers.¹⁻²

Before the housing crisis, Freddie and Fannie were profitable but held little capital in reserve.³ Rising loan defaults led to major losses, and the federal government rescued the failing GSEs with a \$187.5 billion bailout in 2008.⁴ All bailout funds have been repaid, but both firms operate under a government conservatorship that will last until Congress or their regulator, the Federal Housing Finance Agency (FHFA), acts to end it.⁵



In recent weeks, Treasury Secretary Jacob Lew and Federal Reserve Chair Janet Yellen have expressed concerns that tight credit is holding back home sales, and slowing markets could pose a potential threat to the U.S. economy.⁶

Congress has been debating the future of Fannie, Freddie, and government involvement in the housing market. Meanwhile, new FHFA Director Mel Watt has decided that the mortgage giants should focus on making more credit available to homebuyers instead of pulling back from the mortgage market.⁷

Policy Switch

In his first public speech, Director Watt announced a new set of guidelines intended to expand access to credit and support the housing sector.

- Watt said the agency will not change the current loan limits for “conforming” mortgages that can be purchased by Fannie and Freddie (\$417,000 in most places and up to \$625,500 in high-cost areas). Previously, the FHFA was considering a plan to lower the maximum loan amounts, a move that could undercut recovering housing markets.⁸

- The FHFA will relax the terms for when GSEs can demand that sellers repurchase a faulty loan. Some lenders have paid billions to buy back and settle suits over bad loans and may have adopted stricter lending standards in fear of potential “putbacks.” The expectation is that lenders will loosen underwriting standards and be willing to approve more mortgages.⁹

Reform Efforts Stall

Bipartisan legislation seeking to overhaul the nation’s mortgage finance system, reduce the federal government’s role in the housing market, and protect taxpayers from future bailouts recently cleared the Senate Banking Committee. The Johnson-Crapo bill would eliminate Fannie and Freddie, and private institutions would take over the securitization and insurance functions. Government reinsurance on the securities would kick in only after private capital is wiped out.¹⁰

The bill hasn’t won broad enough support to be taken up by the full Senate. Some lawmakers think that Fannie and Freddie should be restructured rather than dismantled. Opponents believe the plan gives lenders too much control over the credit market; some are worried about higher borrowing costs that could shut some buyers out of the market.¹¹

Housing Challenges Remain

The housing recovery is still fragile, and markets have shown signs of weakness in recent months.

March home sales were fairly soft, falling 0.2% year over year.¹² On top of tight credit, rising mortgage rates, higher prices, and a harsh winter are thought to have stifled sales, though it appears that affluent buyers have fared better than entry-level buyers under these conditions.¹³

In fact, many younger households with stable incomes may have been sidelined by strict underwriting standards or because they were carrying student debt that affects their ability and willingness to take out a mortgage.¹⁴

Some homeowners who would like to move may be waiting because they owe more than their homes are worth, or because selling wouldn’t free up enough equity for a down payment on another home. At the end of the first quarter of 2014, about 18.8% of U.S. households (9.7 million) with mortgages were underwater, and another 10 million had equity of 20% or less.¹⁵

The \$10 trillion U.S. mortgage market is a complex and critical part of the nation’s economy, yet it’s still unclear whether reform efforts will bring about a different and/or stronger mortgage finance system for the future. Even so, short-term policy changes that seem minor in comparison could still affect many potential homebuyers and sellers.¹⁶

1, 4) Reuters, May 13, 2014

2–3, 5, 10–11, 16) *The Wall Street Journal*, May 15, 2014

6–8) *The Wall Street Journal*, May 13, 2014

9) MarketWatch, May 14, 2014

12) National Association of Realtors, April 22, 2014

13) MarketWatch, April 9, 2014

14) MarketWatch, May 15, 2014

15) *The Wall Street Journal*, May 20, 2014