THE HAMILTON PROJECT

Proposal 13: Increasing the Role of the Private Sector in Housing Finance

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Deficit Reduction (10-year): **$134 billion**

Broader Benefits: **Improves incentives for risk taking and investment in the mortgage market and market for homes; reduces taxpayer exposure to risk; fosters competition and innovation in housing finance.**

Introduction

This paper proposes reforms of the U.S. housing finance system to increase the role of private capital in funding housing, reduce taxpayer exposure to housing risk, sell off the government stakes in the mortgage finance firms of Fannie Mae and Freddie Mac, and charge appropriate premiums for secondary insurance provided by the U.S. government on housing securities. These measures would generate revenues for the federal government, improve the allocation of capital within the U.S. economy, and focus governmental assistance for affordable housing on those most in need. With reform, private firms would securitize qualifying mortgages into mortgage-backed securities (MBS) and pay for a secondary government guarantee, while considerable private capital would take losses ahead of the government. The U.S. government would support homeownership and access to housing financing, but with transparent subsidies rather than implicit guarantees, better protection for taxpayers, and a clear delineation of the roles of the public and private sectors.

At the center of housing finance reform is an agenda to unwind the conservatorship of Fannie and Freddie that has stabilized these two government-sponsored enterprises (GSEs) since September 2008. Taxpayer support has ensured that mortgages have been available throughout the financial crisis even while other credit markets have been strained, but at a cost to taxpayers of roughly $132 billion so far, including $187.5 billion put into the two firms less $55.2 billion in dividends received (FHFA 2012e).

Moving forward with reform will return some or perhaps a good deal of the money put into Fannie and Freddie to the government, but not necessarily the full amount. Indeed, a key point of this proposal is that actions that maximize the financial return to taxpayers do not align with desirable housing policy. The U.S. Treasury now receives all of the profits of the two GSE firms and might well maximize revenue through an indefinite conservatorship in which private capital is effectively shut out of securitization for government-guaranteed MBS. A reform that brings in private sector competition would not necessarily maximize the value of the government stake in Fannie and Freddie, but it would mean better possibilities for the innovation and beneficial risk taking that go along with private sector incentives. The crisis gave financial innovation a deservedly bad name, but innovation is still valuable in the financial system. This can be seen today: borrowers with imperfect credit histories have trouble obtaining loans, even though low interest rates and the tight rental market mean that monthly mortgage payments for many might be no greater than rent. Housing finance reform that leads to a system with diverse sources of mortgage funding including both guaranteed and nonguaranteed mortgages would provide channels by which private investors can extend mortgage credit to borrowers who are now unable to obtain loans.

ACKNOWLEDGMENTS: I thank Adam LaVier for insightful comments on an earlier draft.

Similarly, Fannie and Freddie would be most valuable in a privatization sale if they are allowed to dominate the business of mortgage securitization as in the past rather than face new competition. It would be better policy, however, for reform to foster a system in which new firms can compete in the business of securitization of guaranteed MBS. The (inevitable) underpricing of government insurance gives rise to an implicit subsidy. Competition would help ensure that any such implicit subsidy flows through into lower mortgage rates for homeowners rather than being kept by shareholders and management as in the past when Fannie and Freddie had considerable market power as duopolists. The federal government will not assure any homeowner any particular interest rate. But entry by new firms into securitization and origination will place competitive pressure on banks and securitizing firms that reduces excessive interest rate spreads between yields on MBS and mortgage interest rates paid by homeowners. The importance of competition is illustrated by the present situation in mortgage origination, in which the absence of competition means that low yields on MBS do not fully flow through to reduced mortgage rates for borrowers.

Such a proposal could have a budgetary impact of roughly $134 billion. Any gap between the budgetary recovery and the amount of the bailout will represent the cost of the former housing finance system under which the government provided an implicit guarantee on Fannie and Freddie and thus took on housing risk without proper compensation, while allowing the private shareholders and management to capture part of the benefits of government support for homeownership.

The Challenge

The U.S. government now guarantees more than 90 percent of new mortgages and refinances, effectively crowding out private capital from housing. A challenge for moving forward with housing finance reform is that an abrupt end of the government backing for Fannie and Freddie could make it difficult for many Americans to obtain desirable mortgage products such as long-term fixed-rate loans. Further delay, however, risks having the two firms become permanent parts of the government, leaving taxpayers at greater risk in the event of another housing downturn and meaning that the U.S. economy misses out on the benefits of having private investors guide lending decisions and take on the risks and rewards of allocating capital to housing.

The proposal here involves a transition in which private sector capital comes in over time to stand at risk ahead of a secondary government backstop. This transition will start from the current situation in which the federal government guarantees Fannie and Freddie as entities, and the two firms in turn provide guarantees for the performance of qualifying MBS without private capital being at risk, other than homeowner down payments and any private mortgage insurance. In principle, the transition could end up with a fully private system in which private capital takes all housing risk. Reaching this point requires a transitional process through a hybrid model with both the public sector and private capital involved, in which the share of housing risk borne by the government guarantee declines over the transition. Reform can thus begin by gradually increasing the amount of private capital at a first-loss position without making a decision about the nature and extent of government involvement in the end-state.

The initial steps of reform will involve creating the government capability to sell secondary insurance on MBS, setting up the common securitization platform to allow new firms to compete with Fannie and Freddie, and gradually increasing the private capital required for MBS to qualify for the guarantee.

Mortgage interest rates (that is, interest rate spreads over Treasury securities) will rise as the transition proceeds, reflecting the compensation demanded by private investors. Indeed, under the old housing finance system, proponents of reform were sometimes labeled as anti-housing on the grounds that proposals to safeguard taxpayers against risk would reduce the availability of mortgage financing. The extent to which the government backstop can recede depends on the societal and political response to higher mortgage rates. It could be that at some point the increased taxpayer protection results in an unacceptable change in the availability and cost of credit, and the transition will then stop. Zandi and deRitis (2011) estimate that mortgage interest rates could increase by fifty to one hundred basis points in a hybrid system such as is proposed here, with the precise amount depending on assumptions such as the amount of private capital involved and the required return on private capital.

Any progress toward reform will be an improvement over the current situation in which government decisions rather than private incentives determine which potential homeowners can obtain mortgages. Indeed, an important consequence of reform will be to foster a larger market for nonguaranteed MBS—so-called private-label securitization—in parallel with guaranteed MBS, to ensure that there are diverse sources of financing for housing. Mortgages that qualify for inclusion in MBS with a secondary government guarantee will be relatively safe, while the development of a private mortgage market will provide opportunities for some borrowers to obtain loans funded by private investors willing to take on housing risk without a government guarantee. A private MBS market will return at some point as higher premiums are charged for the secondary government guarantee and increased private capital is required to stand ahead of the secondary government guarantee (though there are other impediments to the restart of private-label securitization, including continuing legal uncertainties for originators such as the threat of future lawsuits regarding loans that go bad).

A second challenge is that after taking in hundreds of billions of taxpayer money, the GSEs are now profitable and generating income for their owner—the U.S. government. The two firms paid dividends in 2012 of nearly $19 billion to the U.S. Treasury and are on pace for a similar amount again in 2013. Such funds have already been spent on purposes unrelated to housing, with revenues from requiring the GSEs to charge higher guarantee fees used to fund a temporary extension of the payroll tax cut. The longer that the GSEs stay in conservatorship, the more likely it is that their future profits will be used to fund such additional government activities. This is especially poor policy because higher guarantee fees are properly viewed as compensation for taxpayers taking on risk. The revenues should be used to build up a capital buffer to pay for future losses and should not be treated as new fiscal resources.

Finally, a key initial step in the transition to housing finance reform will be to change the current federal government guarantee on Fannie and Freddie as entities in conservatorship to a secondary backstop on individual MBS. A challenge is that this appears to enshrine the guarantee, which now exists as contracts between the two firms and the Department of the Treasury rather than as legislation. Formalizing a new government guarantee is understandably seen as undesirable in the wake of the unpopular bailouts undertaken during the financial crisis. In this instance, however, the federal guarantee is to be formalized as a secondary backstop so the extent of the guarantee and thus the risk borne by taxpayers can shrink by bringing in private capital. Even so, this first step remains a key challenge for moving forward with reform.

The Proposal

The proposal is for the U.S. government to sell secondary insurance on qualifying MBS (MBS made up of qualifying loans) to private securitization firms that bundle individual mortgages into guaranteed MBS. For an MBS to qualify for the secondary government insurance, the private securitization firm would both pay insurance premiums to the government and arrange for considerable private capital to be at risk ahead of the government exposure. This private capital would come from a variety of sources, including a combination of homeowner down payments, private mortgage insurance on individual loans, subordinated tranches of MBS that are explicitly not guaranteed, and the equity capital of the private firms undertaking the securitization. All of these sources of capital would take losses on guaranteed MBS and be wiped out before the government pays off on its guarantee.

In the event that a covered MBS takes losses that exceed the credit protection from the mortgage-level layers of capital of the homeowner down payment and private mortgage insurance, investors in the subordinated (nonguaranteed) tranches would next take losses, and then the securitizing firm would make good on the guarantees using the entirety of its own resources before the federal guarantee kicks in. In this event, the securitizing firm would fail. The private shareholders of the securitization firm would be wiped out, while the federal government would make good on payments for owners of insured MBS.

Allowing for entry by new firms undertaking securitization is vital for allowing this outcome, since the ability of new firms to compete in securitization means that a securitizing firm can fail without taking out the entire housing finance system. This would address a salient problem of the old system, in which the federal government felt obligated to prop up Fannie and Freddie in September 2008 to ensure that mortgage financing would continue to be available to American families.

Note that the government guarantee attaches to individual MBS, even though the entire capital of the securitizing firm takes losses ahead of the government backstop. In other words, the private capital of the securitizing firm itself is fully ahead of the government. If a bank were to undertake securitization of guaranteed MBS, the entire shareholder capital of the bank would be at risk, even though the government guarantee covers only the insured MBS and does not cover other liabilities on the bank's balance sheet. This asymmetry is appropriate: it should be extraordinary for a private sector activity to receive a government guarantee. It would not be surprising if entry into securitization takes the form of separately capitalized firms.

The housing finance regulator plays a crucial role in ensuring that underwriting standards remain high for guaranteed loans and that there is adequate high-quality capital ahead of the government. The regulator is further responsible for setting up a pricing mechanism for the government guarantee, and for setting up the insurance fund out of which to cover losses on guaranteed MBS. The regulator would have to ensure that financial institutions of all sizes, including community banks, have access to the housing finance system. Given the specialized expertise involved, it makes sense for the Federal Housing Finance Agency (FHFA) to carry out these duties, collaborating and consulting as appropriate with other agencies, including bank regulators, the Consumer

Financial Protection Bureau, and the Securities and Exchange Commission.

Allowing new firms to compete on equal terms with the newly privatized Fannie and Freddie is socially beneficial in at least two ways. First, competition helps to ensure that any implicit subsidy from underpriced federal insurance is passed through to lower interest rates for homebuyers. That is, this proposal takes as an inevitability that the federal government underprices insurance. The benefit of allowing for competition is to have the implicit subsidy created by the underpriced insurance reach the desired group of potential homebuyers rather than having securitizing firms capture the implicit subsidy. Second, with multiple firms undertaking securitization, one of them can be allowed to fail without disrupting the availability of housing mortgages. Housing finance reform would thus move away from the situation where firms are too important to fail.

As reform proceeds, the government would sell its stakes in Fannie and Freddie back into private hands. James Millstein and Phillip Swagel in their *Washington Post* Op-Ed ("It's Time to End the Bailout of Fannie and Freddie. Here's How," October 12, 2012) and Swagel (2012) discuss ways to carry this out.[1] The existing investment portfolios of the two firms would run off, and the newly private Fannie and Freddie would be allowed to maintain liquidity portfolios only for limited purposes such as assembling MBS and working out bad loans. The sale of the government shares in the GSEs would provide a key source of revenue for taxpayers. As noted above, the amount recovered depends on the structure of the housing finance market after the privatization.

Premiums for the government's secondary insurance provide the second source of revenue from housing finance reform. Pricing the guarantee is a key issue for reform. In principle, it would be desirable to set premiums that (at least) compensate the government for the risk it is taking on. As discussed by the Congressional Budget Office (CBO; 2012), the government accounting standard under the Federal Credit Reform Act discounts the stream of premiums received using the interest rate on Treasury securities, which is too low because it neglects the market risk that is absorbed by the government but is not priced with the risk-free Treasury rate. The provision of insurance by government agencies can thus appear to have a positive net impact on revenues (a negative subsidy rate in budgetary parlance). In accounting for the GSEs since 2008, the CBO has used a fair value accounting methodology that adjusts for market risk and avoids the potential problem with the Federal Credit Reform Act approach. It will be important to maintain the budgetary treatment used by the CBO to avoid a situation in which the government sets insurance premiums too low to cover the housing credit risk it takes on through the provision of secondary insurance and yet still is able to show a positive budget score which could then be used to offset other activities.

One possibility is that the government could intentionally charge insurance premiums that exceed the fair value level as calculated by the CBO in order to limit the share of mortgages that take up the guarantee. In this case, the secondary government insurance would tend not to be used in normal times when market participants do not want to pay the premiums, but the share of guaranteed mortgages and government support for housing would expand in times of credit market strains (assuming that the government did not increase premiums). The appropriate pricing for the secondary government insurance depends on the amount of first-loss private capital. Guarantee fees on single-family mortgages already have risen considerably over the past five years, from an average of twenty-one basis points in 2007 to twenty-six basis points in 2011 (both figures from FHFA 2012b) and then to forty-six basis points at the end of 2012. This latter figure includes two separate ten basis point increases imposed in 2012, first in April 2012 as directed by Congress in the Temporary Payroll Tax Cut Continuation Act of 2011, and then again in November 2012 at the instruction of the regulator (FHFA 2012c). Guarantee fees are slated to rise farther under the strategic plan put out by the FHFA (2012d). As private capital comes in ahead of the guarantee, the government exposure to housing risk will diminish and the fair value insurance premium would be expected to decrease as well. The price of the insurance together with the amount of required first-loss private capital (the attachment point for the government insurance) determines the extent of government exposure to housing credit risk.

An eventual goal of reform is to use a market mechanism to price the government insurance. A market mechanism for pricing could be put in place by reducing the quantity of insurance capacity so that the government does not offer a backstop for all qualifying mortgages. An auction could then be used to set the premium. This pricing system would ensure that not all mortgages are guaranteed in normal times, though a safety valve mechanism could be put in place to cap the insurance premiums in the event of a crisis.

To summarize, the proposal involves the following key actions:

1. Establish a secondary federal insurance program for qualifying MBS. This program would include requirements for the amount of private capital ahead of the guarantee to increase over time as the housing finance system transitions away from the current GSE conservatorship toward a system with a prominent role for private capital.

2. Sell this secondary insurance to securitization firms that meet the standards established by the housing finance regulator and thereby foster competition in securitization.

3. Use the proceeds of the insurance premiums to capitalize a federal insurance fund with which to cover losses on guaranteed MBS.

4. Wind down the legacy Fannie and Freddie investment portfolios. The Federal Reserve would henceforth act as the buyer of last resort for guaranteed MBS if monetary policymakers judge that elevated mortgage interest rates warrant policy action for the purposes of macroeconomic stability.

5. Sell Fannie and Freddie's securitization and guaranty operations to private investors who will compete with other entrants.

6. Empower the housing finance regulator to carry out its broad array of responsibilities, including ensuring that mortgage quality remains high for guaranteed loans, that adequate private capital is ahead of the guarantee (notably at the level of the firms carrying out securitization), and that premiums for the secondary government insurance are adequate to cover expected future losses on guaranteed MBS.

Housing finance reform involves a host of other steps, the details of which are vital but beyond the scope of this paper. These include development of a common securitization platform so that guaranteed MBS from different firms can trade in a unified pool (FHFA has started on this; see FHFA 2012a); development of needed regulatory measures from the SEC; and development of policies with explicit expenditures aimed at ensuring access to affordable housing.

Over time, higher guarantee fees and increased requirements for private capital ahead of the guarantee will increase the attractiveness of mortgage securitization without a government guarantee. As reform progresses, such private-label securitization will eventually restart; if reform proceeds far enough (guarantee fees and required private capital go high enough), then nonguaranteed MBS could eventually be an important source of funding for housing.

The current proposal can be seen in the context of the three options presented in the U.S. Department of the Treasury and the U.S. Department of Housing and Urban Development (Treasury–HUD) white paper on reforming housing finance markets (2011). Leaving aside the role of the FHA (Federal Housing Administration), the first Treasury–HUD option would involve a fully private housing finance system with no government guarantee. The second option would have a mostly private market in which only a modest share of mortgages in normal times are bundled into MBS with a secondary government guarantee behind private capital. In this second option, the share of guaranteed mortgages would increase in the event of credit market strains. The third Treasury–HUD option would have essentially all qualifying mortgages bundled into MBS with a secondary guarantee behind private capital.

The initial reform steps that raise the guarantee fee and bring in private capital ahead of the government guarantee would first move the housing finance system from the current conservatorship to a model much like that of option three in the Treasury–HUD paper.[2] There would be private capital ahead of the government guarantee, but nevertheless essentially all mortgages would have a guarantee. Continued increases in guarantee fees and in the required first-loss private capital would eventually lead to a decreased market share for guaranteed mortgages and an increased share for nonguaranteed mortgages. This thus moves in the direction of the second option in the Treasury–HUD paper, in which the government guarantees a modest share of mortgages—perhaps 10 percent—in normal times and a larger share in times of crisis. Whether reform moves far enough to reduce the share of guaranteed mortgages all the way to 10 percent (let alone to zero as in the fully private model of the first option in the Treasury–HUD paper) depends on the societal and political response to the higher mortgage interest rates that come about as reform proceeds. The first Treasury–HUD option would be reached if the amount of private capital increases so far that there is no government exposure to housing credit risk.

FINANCIAL RECOVERY

The financial recovery from selling the public stakes in Fannie Mae and Freddie Mac depends crucially on the structure of the securitization market after reform, the pricing scheme adopted by the government for providing secondary insurance on qualified MBS, and the extent of private capital required in a first-loss position ahead of the guarantee. There are tradeoffs between revenue maximization and policy goals in each of these dimensions. Allowing for entry and competition in securitization will reduce government revenue but benefit the housing market through private sector incentives and innovation. Charging a higher price for the government guarantee and requiring more private capital will shrink the share of mortgages that are packaged into guaranteed mortgages, but provide increased protection for taxpayers. Housing finance reform should be undertaken with these broad goals in mind and not with a singular focus on maximizing the return to taxpayers.

While the ultimate revenue impact of housing finance reform is complicated, it is useful to sketch an approximate value of the combined annual profits for Fannie and Freddie as if they were a single company. This provides an upper bound for potential revenues from reform. The firms' main revenue source is the guarantee fee they charge on insured MBS, assuming as above that they in turn pay the government a premium for secondary coverage. The total book of MBS insured is about $4 trillion in a steady state. Zandi and deRitis (2011) calculate that the government would charge fifteen basis points to pay for its secondary insurance in a scenario in which the regulator requires enough private capital ahead of the government to cover losses in a 25 percent decline in home prices. This would be carved out of the total guarantee fee of seventy-six basis points in 2014, according to analysis from J. P. Morgan. After taking into account the cost of the firms' annual expenses of about six basis points as was the norm before the financial crisis (and might be even too much in light of more careful underwriting in the wake of the crisis), this leaves earnings from securitization of fifty-five basis points. On a $4 trillion book of guaranteed MBS, this gives annual earnings of $22 billion from single-family securitization.

The GSEs have other sources of revenues, notably a profit rate of roughly fifty to sixty basis points on about $400 billion in guarantees on multifamily residential properties; this adds another $2 billion in earnings. In the past, the GSEs sold debt with an implicit guarantee and invested the proceeds in MBS with a higher yield—essentially running a hedge fund with government backing. These investment portfolios will dissipate as part of reform and for that reason are not included here.

Combined annual profits of around $24 billion result in aftertax earnings of $16.8 billion assuming a 30 percent average corporate tax rate. With a conservative price-to-earnings ratio of only ten to one, this results in a market capitalization of $168 billion. By comparison, the banking sector had a ratio of market capitalization to net income of fourteen in January 2012, according to the dataset collected by Aswath Damodaran (Damodaran 2013). The smaller multiple is appropriate for the GSEs since their activities are less diversified than banks' activities.

If the GSEs are potentially worth up to $168 billion in the event that they are sold off in a setting in which they do not face competition, the next question is how much the government would receive through reform. The contracts between the Department of the Treasury and the two firms involve the Treasury purchasing senior preferred stock as needed to ensure that the firms stay in business (that is, that they have positive net worth); these preferred shares represent the $187.5 billion in taxpayer capital injections to date. In return for this support, the Treasury received warrants for 79.9 percent of the common stock of the firms, and 10 percent dividends on the preferred shares. (This is the source of the $55.2 billion in dividends received from the two GSEs.) One issue is whether taxpayers should be satisfied in a privatization to receive back $187 billion or instead only the net of $132 billion. This will affect the government's share of privatization revenue. A second issue is the pace and mechanism by which the firms are privatized. If the firms are sold off slowly, this would translate into a smaller revenue impact, since the CBO will (appropriately) discount the proceeds—and do so using a fair-value interest rate. If the government retains 90 percent of the proceeds of the privatization, roughly in line with $150 billion out of the $168 billion market capitalization, and sells its stake over three years starting in the year after reform commences, then there would be a positive budget impact of nearly $134 billion, assuming that a discount rate of 6 percent is used by the CBO along the lines of past CBO practice for the GSEs.

A reform that allows for entry by other firms into securitization would reduce the market value of Fannie and Freddie and thus the government proceeds from their privatization. With other firms competing in securitization, the government would receive a different stream of revenue from selling off the secondary insurance. Fannie and Freddie would not be worth $168 billion; some of the reduced value would accrue to the private sector firms that compete with Fannie and Freddie, and some would go to the government; the division would depend on the amount of required private capital and the pricing of the government guarantee, which would in turn influence the number of competitors in securitization.

Another alternative would be for the government to simply nationalize the firms and build their profits directly into the budget. Indeed, the U.S. government in August 2012 announced that it would henceforth take all profits of the two firms in lieu of the 10 percent dividends on its senior preferred shares. Fannie Mae and Freddie Mac thus remain private firms in principle, but their earnings accrue to the government indefinitely. Not moving forward with reform is effectively a choice to nationalize the housing finance system by leaving the two firms under government control.

As noted above, GSE reform that brings in private capital will tend to raise mortgage interest rates. Though beyond the scope of this paper, it would be appropriate for housing finance reform to include explicit measures to support access to housing finance and to affordable housing more generally, including rental housing. Indeed, one could imagine adding a funding source for affordable housing on top of the guarantee fee paid to the government for the secondary insurance.

Conclusion

Government officials involved in the rescue of Fannie Mae and Freddie Mac in September 2008 did not anticipate that the two firms would remain in taxpayer hands more than four years later. This delay highlights the political challenges of moving forward with housing finance reform. With the government guarantee on Fannie and Freddie, mortgages are available to qualified buyers. It is a natural inclination for the political system not to make changes to policy areas that seem to be working. With reform, however, the housing finance system could better serve the needs of Americans while protecting the interests of taxpayers.

Moving forward with reform requires formalizing the government role in housing, which is undesirable to many policymakers, even if this is but the first step in shrinking the government exposure. In the meantime, however, the government is taking on housing risk without private capital ahead of it, and potential homeowners with imperfect credit histories find it difficult to qualify for mortgages. With the GSEs now profitable and potentially turning into a source of substantial revenue to the government, further delays in reform could lead to Fannie and Freddie becoming permanent wards of the state.

It would be better to avoid this outcome by selling the GSEs back into the private sector. In addition to the positive budget consequences, moving forward with housing finance reform can improve the allocation of capital in the overall economy by ensuring that private incentives drive decisions regarding the financing of housing, reduce taxpayer exposure to risk, and foster competition and innovation in housing finance with the potential to benefit potential homeowners, especially for those who now have limited access to credit and thus to homeownership. Indeed, the value for society of this competition is such that the government should understand that it will receive a lesser value for its holdings of Fannie and Freddie when other firms are allowed to carry out securitization for MBS with a secondary government guarantee.

Housing finance reform will have considerable implications for families at all income levels and for the housing market as a whole. For families most in need of affordable housing, reform would provide an opportunity for the government to revitalize programs aimed at boosting the availability and affordability of decent living accommodations, including rental housing. As noted above, the proposal here provides a natural funding source for such activities.

For potential homeowners, the effects of higher insurance premiums (the increased guarantee fees) and private capital in a first-loss position ahead of the secondary government guarantee would tend to put upward pressure on mortgage interest rates. Offsetting these factors to some degree, however, would be the beneficial impacts of increased competition that would reduce profit margins for housing finance firms and thus be associated with downward pressure on mortgage interest rates. On balance, mortgage interest rates likely would increase with housing finance reform, but this would reflect the increased protection for taxpayers, who would bear a greatly reduced share of the housing risk in the U.S. economy—and would be compensated for doing so.

One positive sign is that the initial steps toward reform are part of the FHFA's strategic plan, including a program already under way to increase the fees charged for MBS to receive the government guarantee, and a program still under development to bring in private capital in the form of nonguaranteed tranches of MBS. The FHFA is also developing a common securitization platform that would standardize guaranteed MBS and thus facilitate new firms' entry into securitization. The ultimate disposition of Fannie Mae and Freddie Mac, however, and thus the full eventual return of the taxpayer support, will await congressional action.

Mortgage interest rates are near record lows and the housing market is finally rebounding after an epic collapse. Reform will likely lead to higher mortgage interest rates, but if the reforms are gradual, their impact is not likely to undo the housing recovery. And reform will have important benefits in improving the fiscal position of the United States, the overall allocation of capital to housing and other uses, and possibly the availability of mortgages to potential homeowners currently unable to obtain financing. Now is the time to move forward with housing finance reform.

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Endnotes

1. For further discussion, see Nick Timiraos, "A Plan to Alter Fannie, Freddie," *Wall Street Journal*, October 21, 2012; and *Wall Street Journal* (2012).
2. See Swagel (2012) for details.

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FEBRUARY 2013

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