



# AMERICAN BANKER.

## FHFA Should Test Mortgage Reforms Before Congress Commits to One

Dwight Jaffee and Mark Willis

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Just as you wouldn't buy a car without taking it for a spin around the block, lawmakers should not attempt to reform our housing finance system with untested policies.

With the future of Fannie Mae and Freddie Mac in flux, the Federal Housing Finance Agency, their regulator and conservator, is uniquely situated to take much of the guesswork out of reforming our housing finance system. By test-driving potential features of a reformed housing finance system, the agency can help inform the ongoing debate in Washington without foreclosing future policy options. The result should be a better and smoother path to housing finance reform.

The key is for the FHFA to bring private capital artfully into the mortgage lending process to reduce the 90% of the single-family mortgage market "owned" by the government. The required "art" is to do so without risking major disruptions in the availability of mortgages or unnecessarily raising the cost for most borrowers.

Properly structured test drives will inform policymakers on alternative strategies while helping to create the so far elusive consensus on the required extent of government-based mortgage

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guarantees. At the same time, the test drives can also inform policymakers on the benefits of bringing in private capital to take the first-loss positions ahead of the government.

The first test is for the FHFA to raise the charges imposed by Fannie and Freddie only on loans exceeding \$417,000, the mortgage limit above which government support has not traditionally been provided. Increased charges on Fannie- and Freddie-backed mortgages would allow the private sector to compete for this part of the mortgage market, revealing the types and costs of mortgage products that private capital is willing to finance on its own.

If the cost and product mix of these loans turns out to be acceptable, then a second step would be to lower the cap below \$417,000 in stages, thus expanding the part of the market where the private sector can compete, while continuing to test for the impact on cost and product mix.

But it may turn out, as many have argued, that some government guarantee on mortgage-backed securities is justified in order to maintain the availability of well-priced 15- or 30-year fixed-rate mortgages that have been at the core of the U.S. housing market. In anticipation of this possibility, the FHFA should also continue its current quest to determine the costs and constraints of bringing in private capital ahead of a government guarantee on mortgages beyond those traditionally covered by the Federal Housing Administration.

But the FHFA needs to conduct these trials without further raising the fees imposed on borrowers by Fannie and Freddie until a final determination is made on whether and how to structure in such private capital. Options to consider include capital market structures as well as loan-level insurance, as has recently been proposed by the Mortgage Bankers Association. Meanwhile, the results of these tests of the market will inform such a determination by laying out more clearly the trade-offs that must be considered in bringing in private capital if it also reduces affordability and access to safe mortgage products.

Private capital can help insulate taxpayers from risk (as can higher premiums charged for the government guarantee), can provide an additional set of eyes to monitor the quality of the loan process and spot inherent risks, and can discourage politicians from meddling with underwriting standards. In addition, competitive pressure always makes the market more responsive to consumers' needs.

On the other hand, private capital ahead of a government guarantee will increase the cost of mortgages and limit the ability of the government to support the mortgage market during economic downturns when private capital pulls back, as we witnessed after the housing bust. It is simply naive to expect private-sector investors to adjust their expectations of an acceptable return in order to make homeownership more accessible and affordable or to put capital at risk during market downturns.

Reforming the housing finance system cannot and should not be done in a rush, especially since we lack basic information on the likely impact of the various alternatives that have been proposed. Going for a few test drives should help us avoid accidentally undermining the housing market or causing it to go into reverse. The FHFA is uniquely positioned to generate fact-based evidence to help lawmakers make informed decisions as to the optimal blending of public and private capital in the mortgage finance system.

*Dwight Jaffee teaches finance and real estate at the Haas School of Business at the University of California, Berkeley. Mark Willis is a resident research fellow at New York University's Furman Center for Real Estate and Urban Policy, where he also teaches housing and community development policy.*

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