



March 19, 2008

Fannie and Freddie freed to boost mortgage market

By Saskia Scholtes in New York

Fannie Mae and **Freddie Mac**, the government-chartered mortgage financiers, on Wednesday got the go-ahead from their regulator to pump as much as \$200bn of liquidity into the beleaguered US mortgage market.

The Office of Federal Housing Enterprise Oversight (Ofheo) reduced surplus regulatory capital requirements for the mortgage companies from 30 per cent to 20 per cent, and secured a commitment that they will each soon raise a "significant" amount of new capital to allow them to buy and guarantee more mortgages.

Ofheo said the move is a bid to give Fannie and Freddie the flexibility to support the highly distressed market for so-called "jumbo" mortgages greater than \$417,000, as well as the capacity to refinance more subprime home loans and conduct loan modifications for struggling borrowers.

"Both companies have prudent cushions above the Ofheo-directed capital requirements and have increased their reserves," said James Lockhart, director of Ofheo. "We believe they can play an even more positive role in providing the stability and liquidity the markets need right now."

Freddie's shares were 13 per cent higher in morning trade on Wednesday, while Fannie Mae was 10 per cent higher. US Treasury Secretary Henry Paulson said the decision was "encouraging" and should provide a boost for the mortgage market.

However, some analysts expressed doubts the new flexibility for the agencies would go far enough. Josh Rosner, consultant at Graham Fisher said: "This will make a psychological difference in the short-term, but the agencies are not going to be very aggressive - they have become very risk averse from a credit perspective."

Dan Alpert, managing partner of Westwood Capital, an investment bank, said: "Washington believes this is a liquidity crisis. But this is a credit crisis brought on by the falling value of underlying housing assets." The 30 per cent regulatory capital surcharge was imposed on the mortgage financiers after past accounting scandals, and in the current crisis has led mortgage investors to worry that capital constraints could limit Fannie and Freddie's ability to buy mortgages.

Ofheo has come under pressure from lawmakers in recent months to grant Fannie and Freddie greater flexibility to bolster the housing market, including by increasing the size of loans eligible for the businesses.

Ofheo last month allowed Fannie and Freddie to expand their mortgage portfolios by removing caps put in place until both companies were current with their financial statements. The regulator said on Wednesday that Fannie had complied with Ofheo's requests for stricter internal risk controls and Freddie had only one more requirement to meet. Just last month, however, analysts said Ofheo's tone on the capital surcharge was more inflexible, leading to speculation the regulator bowed to pressure from the Bush administration. "We believe that Ofheo director Lockhart took this action only after considerable pressure and likely against his best judgment," said Mr Rosner.

Both companies were forced to raise \$13bn of new capital in the fourth quarter to meet the surplus capital requirement, and around half was subsequently wiped out by record fourth-quarter losses at both companies.

The reduction of the capital surcharge frees up \$2.6bn of regulatory capital for Freddie and \$3.2bn of capital for Fannie. Neither company has indicated how much new capital they are likely to raise, or what form it is likely to take. However, Freddie Mac last week ruled out any "dilutive capital raising" plans and reiterated on Wednesday it would not raise capital that would "adversely impact existing shareholders."