Forbes.com

July 23, 2008

Business In The Beltway Help Is On the Way

By Brian Wingfield

Nearly a year and a half into the U.S. mortgage crisis, Congress has taken its most significant step in coming to the aid of beleaguered borrowers and propping up mortgage buyers Fannie Mae and Freddie Mac.

Tuesday, the House of Representatives voted 272 to 152 on a mammoth housing package. At its center is a $300 billion government insurance fund for refinanced mortgages and a potentially $25 billion provision giving the U.S. Treasury Department the authority to buy shares of Fannie Mae and Freddie Mac if the shareholder-owned companies get into financial trouble.

The bill is expected to become law--perhaps in less than a week. Earlier Tuesday, the White House reluctantly dropped its opposition to a provision that provides $4 billion in grants so that communities most affected by the mortgage meltdown can buy foreclosed homes. The Senate is likely to approve the bill within the next few days.

The message is clear: Help is finally on the way. But who this bill helps most is up for debate.

Is it Fannie and Freddie, which now have an explicit guarantee of the government's support? Is it the 400,000 families who will get some relief from foreclosure? The speculators and reckless borrowers, who can trade in their rotten loans for federally insured loans? Or is it the banks, which won't have to deal with as many foreclosures?

Here's who the bill won't help: taxpayers. They're now on the hook for as much as $25 billion to rescue Fannie and Freddie, should the Treasury need to throw the mortgage buyers a lifeline, according to the Congressional Budget Office. (However, the CBO also estimates that there's a greater than 50% chance that this won't be necessary.)

House Financial Services Committee Chairman Barney Frank, D-Mass., says the bill will stabilize the housing market without costing taxpayers a dime. That's because it's dependent on Fannie and Freddie, which will fund the new insurance program for refinanced mortgages, to be healthy. If they're not--and if the Treasury's rescue plan is needed--the House will likely need to abandon its strict spending rules at the expense of the federal budget.

The nearly 700-page bill has some awfully big-government provisions. It increases the federal debt limit by $800 billion to $10.6 trillion. It gives first-time homebuyers a tax credit of up to $7,500 (which must be paid back to Uncle Sam). It sets aside $180 million in federal grants to counsel borrowers on the foreclosure process. And it creates a national licensing and registration system for loan originators.

The most significant changes, of course, involve Fannie and Freddie, which just five months ago were still subject to 30% capital surplus requirements, a punishment of sorts for their accounting scandals earlier in the decade. (Those surplus limits were lowered to 20% in March in order to marshal the companies' aid in dealing with the mortgage crisis).

When this bill becomes law, Fannie and Freddie will have a new, stronger regulator with the power to raise the companies' capital standards and restrict executives' pay. In the country's most expensive areas, Fannie and Freddie's permanent loan limit increases from $417,000 to $625,000. And they get an 18-month increase in their credit lines from the Treasury, should they need it.

"We basically made the decision that the government needs to get into the mortgage market," says Dan Alpert, managing director of New York-based investment bank Westwood Capital, who has extensive experience dealing with mortgage-backed securities. The risk: exposing the market to political manipulation. Alpert says it's important to have a strong regulatory regime in place to make sure this doesn't get "out of hand" and that the companies' shareholders don't get a free ride.

The biggest lesson in the months-long process of creating this bill is that the government will act swiftly when it's concerned that certain entities are too important to fail. Congress first started examining predatory lending practices as far back as February 2007. But the event that really caused lawmakers to act was a massive sell-off in Fannie and Freddie's stock two weeks ago. Since then, Republicans and Democrats have quickly put aside their differences in order to produce a housing bill.

House Majority Leader Steny Hoyer, D-Md., says the bill is "not about a bailout." Maybe not technically. But for Fannie and Freddie, it's a heckuva makeover.