

The Future of the GSEs: Short-run and Long-run

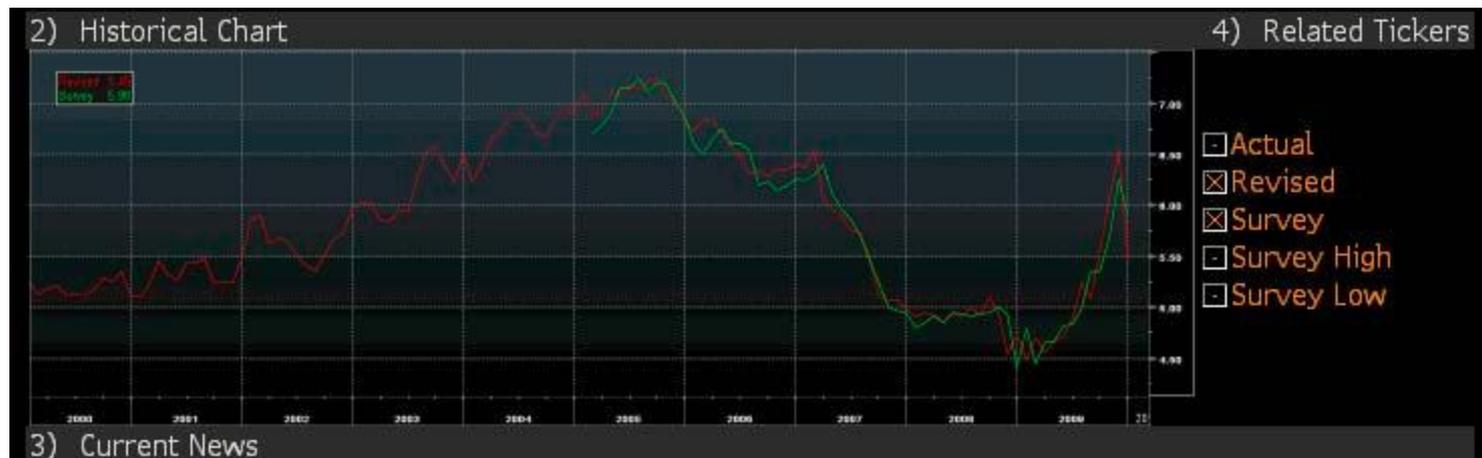
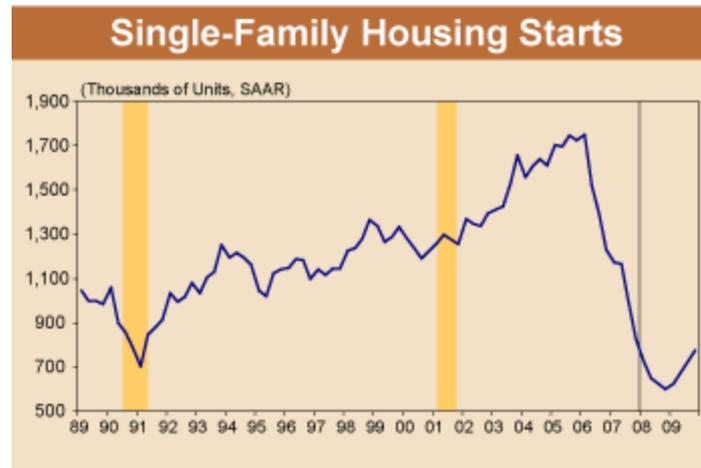
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For presentation to the Federal Reserve Bank of
Cleveland 2010 Policy Summit ,
June 10, 2010

Short-run and long-run Fannie/Freddie models

- Fannie and Freddie serve the purpose of purchasing mortgage loans from lenders
 - Especially since lenders are still not making loans without selling them to the GSEs
 - According to the MBA, the refinance share of mortgage activity is 73.8 percent of total applications (June 2010)- do we need DiTech 2?
 - With slow housing starts and existing home sales, are Fannie and Freddie critical in the short-run?

Housing starts and existing home sales



What are the objectives of F&F alternatives?

- Objectives of F&F “Reform”
 - Free up funds for new lending in the primary mortgage markets and creation of more liquidity in the secondary mortgage market
 - Encourage more competition in mortgage markets
 - Reduce government influence in mortgage markets and residential real estate investment to improve the allocation of capital and substantially moderate the over-investment in housing.

Good bank/bad bank Model

- How do we accomplish these objectives?
- Apply the good bank / bad bank model to Fannie and Freddie (and related entities)
 - Strip out the bad loans and place in separate entity that specializes in loan workouts (bad GSE).
 - Similar to the creation of RTC and funded by federal guaranteed debt in the short-run.
 - In the long-run, auction these to private financial institutions including private equity funds.

Good bank/bad bank Model

- Keep performing loans and “good” guarantee book in good GSE in the short-run.
 - In the long-run, auction these to the private sector financial companies and other market participants.
 - Private companies will make new loans without government guaranteeing their debt or loans.

Alternatives

- Alternatives have been discussed such as
 - Leaving Fannie and Freddie in place and limiting their activities through stricter regulation
 - Create a co-op (or similar) model for Fannie and Freddie with a credit wrap (or government guarantee).
 - But even if these approaches are adopted, a good bank / bad bank model is necessary to get lending flowing again.

And banks too

- As we wrote (with Bob Van Order) in “Securitization vs. Traditional Banks: An Agnostic View of the Future of Fannie Mae, Freddie Mac, and Banks,” we should apply a level playing field for our banks and the GSEs
 - That is, a good bank/bad bank model for our insolvent (or de-facto insolvent) banks.
 - This may be the only way that banks really start lending again.