July 23, 2008

Comprehensive Housing Crisis Legislation: Questions and Answers

Q. Why is the Bush Administration and Congress working to build market confidence in Fannie Mae and Freddie Mac?

Fannie Mae and Freddie Mac are central to the housing market, and the economy as a whole. Of the $5 trillion in debt guaranteed and mortgage backed securities issued by these two Government-Sponsored Enterprises (or GSEs), over $3 trillion is held by domestic financial institutions, including commercial banks, savings and loans, and credit unions. Their size and scope and their stability is critical to our financial markets.

These GSEs are also the largest sources of mortgage finance in the United States, buying more than two-thirds of new mortgages in the first three months of 2008.

With our economy already on the brink of recession, we cannot afford more uncertainty in the financial and housing markets. If these mortgage companies were to fail, money for new mortgages would dry up. Home prices, already falling, would collapse. More homeowners would default. It could also result in a cascade of bank failures, as banks and other investors hold $1.3 trillion in securities issued or guaranteed by Fannie and Freddie. That would dry up credit and would guarantee a deep recession.

The best way to protect taxpayers is by providing assurances that the GSEs can access capital on a temporary basis, but only if absolutely necessary as requested by the Bush Administration. That will boost market confidence in the two companies and reduce the likelihood that the government would ever need to lend a hand.

This bill safeguards the interests of the American taxpayer while shoring up the housing market. Taxpayers must be paid back before investors and the new regulator must approve all executive compensation any time the new authority is invoked.

Q. How much is this action going to cost taxpayers?

We do not expect it to cost a dime. The Congressional Budget Office says "There is a significant chance -- probably better than 50 percent -- that the proposed new Treasury authority would not be used before it expired at the end of December 2009. If the proposal is enacted, private markets might be sufficiently reassured to provide the GSEs with adequate capital to continue operations without any infusion of funds from the Treasury; during that time, it is possible that expectations about the duration and depth of the housing market downturn may brighten. Under that scenario, the temporary authority would not be used and thus would involve no budgetary cost." [7/22/08]

In addition, Freddie and Fannie are taking critical steps to avoid the need to for federal funds – with Freddie Mae announcing last week that it would raise at least $5.5 billion in new capital. [NYT, 7/19/08]

CBO estimates that the expected budget cost of this proposal would be $25 billion over fiscal years 2009 and 2010 – accounting for both the possibility that federal funds would not have to be expended and the possibility that the government would have to use that authority to provide assistance to the GSEs. But in the unlikely event that this emergency authority is tapped, taxpayers will be paid back first, and will take profits before any dividends are paid to stockholders.

Q. Shouldn't stockholders bear the burden of the decline of Fannie Mae and Freddie Mac?

Stockholders have already lost 77 percent on their stock in Freddie Mac and Fannie Mae so far this year. In the unlikely instance that federal funds are tapped, the bill insists that the GSEs agree to pay back taxpayers before paying dividends to investors.

Q. Shouldn't there be new regulation on Fannie Mae and Freddie Mac?

The bill creates a strong, independent regulator with the authority to set strong capital standards so markets can count on the safety and soundness of Fannie Mae and Freddie Mac and so that they can continue to provide our nation's families with affordable housing, as Democrats have been calling for since 2004.

The new regulator will have enhanced authority to set strict prudential standards, including internal controls and audits, and to enforce these new standards and promptly take corrective action.

Congress will be vigilant in conducting oversight and continue of the new regulator to look at the need for further reforms and to ensure that there is no future need to take action to restore market confidence in Fannie and Freddie again.

Q. Why does the measure have funds for local government to buy houses? Wouldn't that benefit speculators in the housing market?

Every American pays when there are large numbers of foreclosures in a neighborhood, because these result in higher crime, declines in home values, and decreased local revenues for schools, fire, police, and other essential community services.

If you take a one-eighth square mile -- the size of a city block -- and you end up with one foreclosure on that city block, two things happen immediately: the value of every other home on that city block declines by one percent immediately, and the crime rates go up two percent immediately. There are also lost revenues for police, and fire, and social services. [Chairman Dodd, NPR, 3/28/08]

The measure is not a bailout. Instead, it requires that foreclosed properties be purchased <u>at a discount</u> from their current appraised values—taking into account their current condition—to ensure against overpayment. For the first 5 years, any profits from sales, rentals, or redevelopment of assisted properties must be reinvested in affordable housing and neighborhood stabilization.

The bill is supported by the National Governors' Association, U.S. Conference of Mayors, National Association of Counties, National Association of Local Housing Finance Agencies, National Community Development Association, and the National Council of State Housing Agencies, as well as a wide range of civil rights, community development, labor, and low-income housing groups, including: AFL-CIO, AFSCME, Catholic Charities, Enterprise Community Partners, Local Initiatives Support Corporation, National Low Income Housing Coalition, National Housing Conference, and the National Urban League.

Q: How does the FHA rescue program work?

A: H.R. 5830 is a voluntary program for homeowners and lenders or holders of existing mortgages. The process begins when a homeowner or servicer of an existing eligible loan contacts an FHA-approved lender. That FHA-approved lender then determines the size of a loan that meets the requirements of the program and that the borrower could reasonably repay. If the current lender or mortgage holder agrees to write-down the amount of the existing mortgage to meet the requirements of the program and make the new loan affordable, the FHA lender will pay off the discounted existing mortgage. The government would only have liability if a borrower defaults and the amount recovered in foreclosure is below the outstanding debt still owed.

Q: Is this package a bailout for speculators, homeowners, investors, and lenders?

A: No. The bill is narrowly tailored to keep families in their homes. For example:

- Only primary residences are eligible: NO speculators, investment properties, second or third homes will be refinanced.
- Investors and lenders must take big losses FIRST in order even to participate. The owner of the old mortgage can get a maximum of 85% of the CURRENT value of the home, NOT the original price. In many cases the loss will be significantly greater, but 15% is the minimum.
- Most homeowners will have seen the equity in their homes disappear before being able to refinance under this program. In addition, the FHA will get a portion of any future profits on the house, to make sure the government recoups its investment over the long run.
- To protect taxpayers' dollars, FHA fees for the insurance are higher than "regular" FHA loans, acknowledging the higher risk posed by these borrowers.

Q: Aren't you rewarding some families who bought homes they could not afford?

A: Many homeowners facing foreclosure were misled, were deceived, or were in other ways the victims of unfair lending practices. Everybody -- homeowners, lenders, neighbors, indeed our entire economy -- is worse off when a foreclosure occurs instead of a prudent refinancing.

And this bill takes action to prevent future abuses by lenders, by establishing a nationwide loan originator licensing and registration system to set minimum standards for all residential mortgage brokers and lenders in an effort to curb abusive lending practices. It also strengthens mortgage disclosure requirements to help ensure that borrowers understand their mortgage loan terms.

Q: **Are you interfering with market forces? Shouldn't the market work this out?**

A: No. Irrational market forces and a lack of oversight caused the crisis in the first place. We are trying to limit the decline in the economy while the housing market recovers. Federal Reserve Chairman Ben Bernanke is calling for Congressional action, saying "doing what we can to avoid preventable foreclosures is not just in the interest of lenders and borrowers. It's in everybody's interest."

Every taxpayer in America pays when large numbers of foreclosures and declining home values result in higher crime and decreased local revenues for schools, fire, police, and other essential services.