Posted By Jeff Collins

U.S. Rep. John Campbell, *R-Irvine, has co-authored a bill to replace mortgage giants Fannie Mae and Freddie Mac with at least five private associations. The two government-chartered entities fostered homeownership by acquiring loans from mortgage originators, keeping cash flowing to borrowers.*

Following the $138 billion (and counting) bailout of the two entities in 2008, Campbell has joined a chorus of voices, including President Obama's, arguing that the government-chartered Fannie and Freddie should be replaced. We asked the congressman to explain his approach to reform …

Us: Everyone seems to agree it's time to put Fannie and Freddie out to pasture, but there's little agreement about what should replace them. What's your solution?

Campbell: Everyone knows that the Government-Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac can't continue as they are presently. But, no one knows what will come next. That uncertainty hangs over the housing market right now and is part of what is holding it back.

I, along with lead sponsor Gary Peters (D-MI), have authored a unique plan to completely dismantle the old GSE system consisting of Fannie Mae and Freddie Mac and replace it with a private sector mortgage finance system that both protects the American taxpayer and gives the marketplace assurance that 30-year fixed rate mortgages will be available in the future on a consistent basis. The Housing Finance Reform Act (H.R. 1859) will shield taxpayers from liability, encourage private sector involvement in the mortgage market, establish certainty for potential homebuyers, and provide confidence for reinvestment in housing.

Us: What are the key components of your plan?

Campbell: Currently, we have a system in which the GSEs are monopoly entities formed by the government. The “associations” we propose in the Housing Finance Reform Act will be entirely private entities. Initially, there will be at least five of them, but, the bill is structured so that there will soon be dozens in order to create competition and spread the risk around. Unlike the existing system, where GSEs can make mortgages, hold them in their portfolios, sell them and engage in all kinds of other businesses.

The associations I propose can only guarantee conforming mortgages and cannot make or hold any mortgages themselves. The only federal guarantee in my plan will be on the mortgages, not the associations, and it will only kick in after the down payment, all capital in the entity, and all capital in the insurance fund is gone.

Furthermore, the associations will pay a market rate to put a guarantee on a group of mortgages. In short, the GSEs were their own special entity and there was and is nothing like them. The associations in my bill will follow the model of public utilities (your electric company, for example) and the banking system. Remember that when you make a deposit in a bank, it is guaranteed by the FDIC. But, the capital requirements, limits, insurance fund and number of banks out there have made the system work even through the recent crisis.

Us: Why shouldn’t we just let the private sector handle home loans?

Campbell: Throughout my lifetime, we have always had some government support for home mortgages. Without some support, the 30-year mortgage will go away. Investors will simply not make loans of that duration, with a fixed rate, and additionally take the 30-year risk that you might not ever pay them back.

If we were to wind down the GSEs without some viable replacement system, home loans would likely require 25% down or more and mortgage durations would fall to 15 years or less. This would easily trigger a 30% decline in housing prices as the payments for any home loan would rise dramatically. This decline would plunge the economy into a major recession/depression and greatly reduce the number of people able to own homes in the future. This is a disaster scenario which is completely avoidable.

The government is making over 95% of all home loans right now through the GSEs and FHA. That alone is proof that there is no viable private market for such loans or it would be developing now.

Us: How will your plan limit the risk to taxpayers?

Campbell: As I mentioned above, my system is very different than the GSEs. The fact that there will be many of these associations and that they are not themselves guaranteed by the government means that they can fail and, if they do, there will be no government money used to prop up the entities.

In order for the taxpayers to be at risk, a group of mortgage portfolios would have to first decline enough to eat through the 20% down payment. Then, the losses would have to eat through the entire substantial capital of the association, which would then have to be insolvent. If that occurs, the losses would still then have to eat through another layer of private capital, which is the insurance fund (again, similar to the FDIC) into which all of the associations pay.

Even then, the government can ask the remaining associations to pay more into the insurance fund to top it up.

Bottom line is that the amount of private capital and the control of these organizations will be such that a collapse like we had in 2008 would not trigger any taxpayer liability.

Us: What’s the Obama administration’s position on your bill? How about the House and Senate leadership?

Campbell: As this bill was only introduced two weeks ago, neither the White House nor House or Senate leadership have taken formal positions yet.

However, the bill fits into one of the options in the range offered by the Treasury Department a few months ago as acceptable solutions. Furthermore, this bill is in the exact political center of the options that are currently being offered in Congress. That is not because I specifically sought to find the center, but because that is where the correct solution lies. Therefore, the bill is getting, and I expect it to have, deep, strong bipartisan support, which is a prerequisite for anything becoming law when you have a Republican House and a Democrat Senate and President.

Us: How many bills are there to reform Fannie and Freddie?

Campbell: There is really only one other alternative to my plan that has been introduced thus far. That bill, offered by Jeb Hensarling (R-TX), would wind down the GSEs and not replace them with anything, except a catastrophic federal guarantee. As mentioned in my earlier answer, that will result in the end of the 30-year mortgage and will trigger a huge drop in home prices, home affordability and most likely lead to a deep and long recession.

On the other end of the spectrum, there are now rumors of a bill to be introduced that would effectively reconstitute the GSEs. The GSE model failed and we should not be bringing it back.

Us: How would your plan affect ordinary home buyers and sellers?

Campbell: If my bill were to become law today, the uncertainties about financing availability that currently plague the housing market would be largely removed. This should immediately assist the housing market in general. It means that homeowners, buyers and sellers could count on the availability of 30-year fixed rate mortgages into the future.

Furthermore, 20% down will be the norm again with availability for 10% down at additional cost. A robust housing market should return and reverse the negative effects that a sluggish market has had on our economy.

Us: Some fear 20% minimum down payments will hamper home sales. You evidently don’t. Why not And why are higher down payments necessary?

Campbell: In our bill, the federal government will only provide a guarantee for 80% or less of the value of the house at the time of the loan. That means you need 20% down. This protects the taxpayer.

But, I understand there needs to be some flexibility here, but the taxpayer must continue to be protected. Therefore, I have included a provision in my bill to allow for a guarantee of 10% down only if the entity originating the loan either buys separate mortgage insurance on that 10% or the originator puts up that capital themselves. In other words, my bill allows 10% down if someone else other than the association created in my bill or the government takes the risk on that 10%.

Furthermore, remember that loans can be made without this guarantee. It is not mandatory. And, it costs money to get it. So, if some in the private sector want to make 5% or no-down loans they can absolutely do it. But, the taxpayer and the associations will have nothing to do with them.