Rep. Campbell's *bipartisan bill would create reserve fund to limit taxpayer losses*

WASHINGTON (MarketWatch) — To maintain the 30-year fixed rate mortgage and to allow the housing finance system, and economy, to recover, the government needs to provide a guarantee for mortgages, according to Republican Representative **John Campbell**.

That premise is a key component of bipartisan legislation **Campbell**, an Orange County Republican, has co-authored. The bill has been lauded by some analysts as the legislation that Republicans and Democrats will agree to as the model for overhauling the troubled government-seized housing giants Fannie Mae (OBB:FNMA) and Freddie Mac (OBB:FMCC) that have already cost taxpayers some $130 billion.

Campbell told MarketWatch in a phone interview that his bill will spark private capital formation and at the same time reassure the faltering markets and put the economy on a positive footing.

This philosophy puts the 56-year-old representative on a collision course with some in his party -—including key Republicans on the House Financial Services Committee of which he is a member — who are seeking a completely privatized mortgage market with no government backing.

The following is a condensed and edited interview with the former auto dealership owner who has represented Orange County for almost six years.

MarketWatch: The purpose of your bill is to set up a new system of financing for the housing market. Can you explain how it works and why you believe a government guarantee is necessary to maintain the 30-year-fixed rate mortgage?

Rep. Campbell: This bill seeks to create five or more firms that we call guarantee associations that would guarantee packages of loans for the secondary mortgage market. These firms would have to have a certain amount of capital on hand as a buffer

against troubled loans. Mortgages that are given a government guarantee must have the first 20% covered by someone else – either a 20% borrower down-payment or if there is less than 20% down, then the originator or mortgage insurer has to take risk on the first 20%.

The buyers of the mortgage securities would pay a fee for the government guarantee and that capital would be used to create an insurance fund, used to pay claims if there were ever a failure of one of these firms.

We feel you need to have some form of government support because the markets won't accept all the other risks on the 30-year fixed rate mortgage. That includes interest-rate risk, duration risk in addition to credit risks. We're putting a lot of private capital in front of the taxpayer but keeping government support to reassure the market.

Q: Why have five or more companies do this guaranteeing? Are you seeking to spread risk and limit the huge costs to taxpayers that we saw with Fannie and Freddie?

A: When you have two guarantors, as we had with Fannie and Freddie, the whole system went down. They were definitely too big to fail. You could always have a bad actor do something and regulators miss it, so you need to have the system set up in a way so that if one association goes down, the system doesn't go down with it.

We hope there will be dozens of these associations, some of which could be specialized in a particular market, such as multi-family homes or with a focus on a particular region, and others could be generalists.

Q : A number of your Republican colleagues don't support this approach and part of their concerns is that they believe the government guarantee involved will continue to drive the moral hazard problem, promoting problematic over-risk taking by large financial institutions who feel they have protection if they fail, followed by another taxpayer bailout. I believe one of your efforts to limit this perception and problem, is this insurance fund you are suggesting. Can you explain?

A: You have moral hazard when someone gets return without bearing the risk. There is a government guarantee, but if you look at the private capital in front -- the homeowner has to put some money down, then the originator and homeowner must have private mortgage insurance, and our concept is that the guarantee associations would have to hold 5% in capital based on what they have guaranteed.

Buyers of guaranteed mortgages would also have to pay a fee into the insurance fund, which would be built into the interest rate which the homeowner would pay. So if one of these entities runs through all its capital, then that fund would be there to cover the losses. Beyond that, if the firm would go through all its capital, then a fee would be assessed on all the other guarantee associations to replenish the fund. Even in an event like 2008 under this system it holds together and taxpayers would not be out of pocket.

Q: Seems to be a consensus among Democrats and Republicans and the Treasury Department that the portfolio holdings of Fannie and Freddie need to be reduced significantly. But there are advocates trying to keep some portfolio holdings, particularly multi-family homes that are used as rental housing. There is a concern that if these entities don’t keep these rental units that could freeze up the rental unit market, but your bill does not envision holding on to multi-family home loans, why not?

A: Once we had five of these new guarantee associations created we would begin seriously winding down and liquidating Fannie and Freddie portfolios completely over five years. In the bill we allow for multi-family as part of the guarantee with these associations, for exactly the reason you suggested. We need to build a lot more rental housing units, and we envision that investors will be able to borrow money for these projects in the same way that homeowners borrow money with a guarantee through the guarantee association, and this will make financing for these projects liquid and available.

Q: So you don’t believe it will be a problem for this market if these entities aren’t actually holding in their portfolio billions of dollars in multi-family homes? You believe that with this approach they could be packaged and sold to investors with a guarantee in a way that keeps that market functioning?

A: Yes. They would have a guarantee behind them as well. Because they are income producing as opposed to an individual’s home, you could make an argument that they

would be more attractive to investors and packaged together.

Q: You don’t have much support for the bill — seems like everyone is in wait-and-see mode.

A: What they are waiting to see is for a nod from the leadership of their committees. This bill is in the political center as well which is what makes it palatable. The focus in Washington is jobs, yes you’ll hear about deficits, but you’ll hear more about jobs over next 14 months. There is consensus that we can’t get the economy out of the ditch if housing stays in the ditch, and we can’t get housing without a consistent and predictable form of finance going forward. This bill, because it’s in the political center, has ability to pass the House, the Senate and be signed by the president if we can get the political courage of some of the leaders to go ahead and push forward something this.

Q: You’ve also introduced another bipartisan bill related to the housing market, but this one goes against recommendation by the White House and many Democrats and Republicans. It would allow the maximum size of loans that can be guaranteed by Fannie and Freddie to remain for two years at the current level of $729,750. Without action by Congress, the limit on loans that Fannie and Freddie can guarantee will drop back to a maximum of $625,500 effective the end of September. Many lawmakers believe a private market for mortgage securities in that jumbo loan price range can emerge without the need for a government guarantee. They point to two private label residential mortgage-backed deals conducted by Redwood Trust, one in 2010 and another in 2011, in the jumbo market as an indication that there is room for a larger private market. The president of Redwood, Martin Hughes, says there is room for more private deals if the guarantee limit is reduced. So what’s the problem?

A: The opponents of the idea of keeping the conforming loan limit in place always point to those two securitizations. We’ve had two jumbo loan securitizations in the past 2.5 years. They say there is a vibrant market out there. It’s just ridiculous. It’s a tiny, tiny, tiny, fraction of the market. The situation today is that some of the standards to get those loans cut out the vast majority of borrowers. I’ve heard of many situations where you are requiring some enormous amount down, such as 50%, and that you must have ‘gold’ credit. The average person here, in Newport Beach, Calif., even if they are buying a $750,000 house, will not have that kind of cash or credit. It keeps a whole lot of people out of the market.

You need a trillion dollars a year of securitizations to handle this sort of thing and you’ve

gotten tens of millions. Whoever makes the loans has to hold them. The FDIC won't allow banks to hold 30-year-fixed-rate mortgages so a lot of these are adjustable-rate-mortgage and much shorter durations. Those people either have to have really good credit, really big down payments or accept a much higher payment. If the limit goes down as scheduled on Oct. 1, 42 states would see a reduction in the conforming loan limit. That's a whole lot of houses that will be difficult to sell because there will be a lot fewer qualified buyers who can buy them. This will put a further drag on the home market which is a drag on the economy and move us towards double dip.

Q: Doesn't seem this bill has much chance of passing. What are its chances?

A: The more likely scenario for this bill is not that it is a stand-alone bill but that it gets included in legislation that will fund the government for fiscal year 2012. That will happen if the leadership of both houses and the White House understand that a failure to pass it will hurt the housing market and economy.