**Viewpoint: Two GSE Policies Hobble a Housing Recovery**
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At a recent House Financial Services Committee hearing on the future of the government-sponsored enterprises, Treasury Secretary Geithner made two points very clear: "A lot of challenges [are] still ahead in housing," and the GSEs, in their current form, must play a major role in revitalizing the housing market.

In the minutes of its March 16 meeting, the Federal Open Market Committee , or FOMC , agreed with Geithner's concern about the housing market, noting that "housing sales and starts had flattened out at depressed levels."

Unfortunately, two GSE policies — raising prices to homebuyers and making lenders buy back loans in unprecedented numbers — are undercutting Geithner's aspirations for Fannie Mae and Freddie Mac.

Starting in March 2008, the GSEs added an "adverse market fee" and "loan-level price adjustments" that raised homebuyers' costs for almost all mortgage transactions. For purchase loans with a 95% a loan-to-value ratio, these price increases now range from 75 basis points for borrowers with FICO scores of between 700 and 719; for borrowers with FICO scores of between 620 and 639, these price increases range from 300 basis points. On a $200,000 mortgage, this adds $1,500 to $6,000 to the borrower's closing costs.

The GSE pricing policy raises several concerns. First, these much higher fees, coupled with the fact the real estate community has learned that Federal Housing Administration originations are not nearly so cumbersome as many thought, have opened the floodgates for FHA activity. The GSEs' pricing policy is steering business to FHA and other government programs at a time when the administration is trying to reduce the government's role in the mortgage market.

Furthermore, GSE pricing policies are impeding the recovery of the private mortgage insurance industry. To give you an idea of the adverse impact on the competitiveness of a GSE loan with private mortgage insurance, look at the comparable pricing for a mortgage with 95% LTV and a borrower FICO score of 660. The cost of the FHA loan is 60% less for the homebuyer during the first five years (or $6,000 less on a $200,000 mortgage).

The principal reason for the difference is not the cost of mortgage insurance. FHA and private mortgage insurance premiums are roughly comparable depending on the LTV and FICO score. The pricing disparity is the result of the additional GSE fees since Ginnie Mae, the primary secondary market outlet for government loans, only charges a guaranty fee (which the GSEs also charge).

The GSE pricing policy also raises a question of fairness to consumers who are making down payments, have good credit and provide full documentation. Why should these new, qualified borrowers pay for the GSEs' past credit policy and pricing mistakes on alt-A loans with stated income and no amortization?

Arguably, an even more serious problem for the housing recovery is the growing impact of the GSEs' loan-buyback policies on the loan guidelines of mortgage originators. Buybacks are the mortgage industry's problem today, but they are fast becoming an impediment to the housing recovery.

I am not referring to buybacks for an error that is a serious violation of program or underwriting requirements that, had it been known, would have changed the credit decision. Mortgage lenders must and do accept responsibility for poorly underwritten loans.

However, the mortgage industry also believes that the GSEs are using buybacks as a loss-mitigation tool in an increasing number of cases. Buybacks are now being required on loans even when, as one lender said, "we did everything by the book." Holding lenders accountable for buybacks because of undisclosed liabilities, occupancy violations (when hidden from the lender) and minor appraisal differences is forcing prudent lenders to reevaluate their credit policies.

The only practical way to hedge against this type of buyback is to tighten credit guidelines. The bottom line is that borrowers who have historically been good credit risks are increasingly likely to be denied credit because of lenders' new credit overlays (for example, higher floors for FICO scores and product restrictions) designed to mitigate the risk created by the GSEs' buyback campaign.

**Lender concerns about unreasonable buyback demands have spilled over to the FHA program. Several very large mortgage lenders believe it is only a matter of time before FHA begins a similar campaign. FHA officials deserve credit for recognizing this issue and offering assurances that indemnifications (FHA's equivalent of buybacks) will be pursued only for material errors that affect a loan's performance.**
In conclusion, when the GSEs and their regulator, the Federal Housing Finance Agency , are asked about these policies, they point out that Fannie Mae and Freddie Mac are in conservatorship and are "conserving" taxpayer money. Unfortunately, as with so many economic issues today, it is not that simple. It may sound like a good idea to increase prices in an effort to recover taxpayer funds, but are higher prices really achieving anything when they merely shift activity to other government programs?

It also certainly sounds good that lenders are being held accountable for their misdeeds. However, when buybacks are demanded on loans underwritten prudently and in accordance with agency guidelines, they are having a far greater impact than the cost of the buyback. Buybacks of this type are discouraging prudent lenders from taking reasonable credit risks.

At a time when Secretary Geithner and others in the administration are deeply worried about threats to the sustainability of the economic recovery, these two GSE policies are placing obstacles in the path to a housing recovery. As the FOMC minutes pointed out, the market faces enough challenges already.