



Insight

Hillary Clinton's Housing Havoc

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Hillary Clinton's housing policy is pretty light on specifics. She says she will “invest \$25 billion to support sustainable homeownership and connect housing to opportunity.” How exactly that \$25 billion will be invested is unclear. The other number she gives is when she says that she will “match up to \$10,000 in savings for responsible homeowners who earn less than the area median income to put towards a down payment on a first home.”

It's not clear who qualifies as a “responsible homeowner,” but let's say that every adult American with a full time job is “responsible.” Based on 2015 data, if each of the 23,468,800 first time homebuyers takes full advantage of the \$10,000 match, Hillary's Clinton's “\$25 billion investment” turns into a nearly \$235 billion government program.

Her housing plan goes on to say that she will “work closely with regulators to make sure that Fannie Mae, Freddie Mac and the nation's lenders meet their responsibility to provide lending in communities that have been historically underserved.” What her plan doesn't mention is a proposal by two of her closest advisors that would merge Fannie Mae and Freddie Mac (the GSEs) into one government-owned corporation called the National Mortgage Reinsurance Corporation (NMRC).

The proposal, from earlier this year, suggests that Congress should replace the GSEs with the NMRC and that the NMRC would build up its capital coffers by offering fixed dividend securities. Assuming the GSEs' portfolio levels stay relatively constant at just under \$5 trillion combined, that means that the NMRC would have to raise around \$175 billion from private investors to retain 3.5 percent capital – the same rate required of the country's largest banks. The proposal also suggests a slight increase in the mortgage rate, and a more significant increase in the guarantee fee (from 70 basis points to 91 basis points).

There are several problems with this. First, the proposal offers no plan for winding down or merging the GSEs. While the idea of a government corporation has its benefits – all the positives of government guarantees with less taxpayer exposure – the NMRC can't exist before the GSEs are dealt with. Lately, the only conversation about reforming the GSEs is based on an idea of recapitalizing and releasing them from conservatorship. This would be a horrible policy in that it allows the status quo to reign supreme at the GSEs and risks them going right back to their recession-causing activities. Thankfully, Clinton's advisors don't explicitly endorse “recap and release,” but having no plan at all for the GSEs is just as bad.

Similarly, the NMRC proposal itself does little to dig out from under the status quo. Its authors explain that the combination of private capital and government backing will protect taxpayers against up to 8.5 percent of losses in the NMRC's total book of business. Considering that the combined rescue of the GSEs in 2008 through the Troubled Asset Relief Program (TARP) and the bailouts were well over [12 percent](#) of the GSEs' portfolio at the time, a best case scenario of protection against 8.5 percent isn't all that appealing. The proposal also will do nothing about the current policy that sweeps 100 percent of the GSEs profits back to Treasury. If such an arrangement remains, the NMRC will have a difficult time convincing investors to buy a security that offers no chance of to reap the corporation's profits.

Another problem is that the proposal completely ignores current GSE shareholders, many of whom are already [in the midst of a legal battle](#) against the GSEs over the decision to sweep all profits since conservatorship into the Treasury, instead of paying out dividends. Whether the NMRC merges the GSEs or winds them down completely, it immediately opens itself to legal complications surrounding shareholders' claims to the hundreds of billions of dollars that, by their accounts, was illegally seized in the Treasury sweep. If NMRC assumes the accounts of the GSEs, these shareholders could easily sue and lay claim to future dividend payouts, thereby shortchanging the NMRC's new fixed dividend securities investors and potentially subjecting the NMRC to a new round of illegal seizure suits.

The high point in the proposal is its recognition of the need to share risk with the private market. Specifically, the proposal states that “[p]rivate mortgage-backed securities investors bear the risk that borrowers pay off their mortgages before maturity, thereby terminating their interest and principal to investors early and reducing investors' expected return” and “[p]rivate credit risk investors bear the risk of borrowers defaulting on their mortgage loans at a rate consistent with any level of market stress short of an economic crisis.” Unfortunately, although the proposal requires homeowners who put down less than 20 percent to have mortgage insurance, it fails to even mention the use of private mortgage insurance as a means of upfront risk sharing.

Perhaps instead of increasing guarantee fees so much, the proposal could consider the use of private mortgage insurance. When private mortgage insurance is allowed to take on some of the risk presented by these riskier mortgages, the GSEs, or, in this case, the NMRC, [don't have to charge as much in fees](#) to cover any potential losses. And when the GSEs are able to charge lower fees on riskier mortgages, they are able to achieve affordable housing goals of expanding access to mortgage credit for low and middle-income households. Not only does that help the borrowers, it also helps the taxpayers when more of the risk is shared with the private market up front.