

National Association of Home Builders

Statement for the Record

**Regarding H.R. 1409,
“The Secondary Mortgage Market Regulatory Improvement Act ”
Congressional Budget Office Study
“Federal Subsidies and the Housing GSEs”**

**Submitted to the Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises,
Committee on Financial Services**

**United States
House of Representatives**

**Washington, DC
July 11, 2001**

The 203,000 members of the National Association of Home Builders (NAHB) appreciate the opportunity to submit our views on H.R. 1409, “The Secondary Mortgage Market Regulatory Improvement Act,” and the May 2001 Congressional Budget Office (CBO) study, “Federal Subsidies and the Housing GSEs.” Both of these are under consideration by the Subcommittee as part of its examination of possible changes to the regulatory structure for the housing-related government-sponsored enterprises (GSEs), specifically Fannie Mae and Freddie Mac.

Fannie Mae and Freddie Mac are extremely critical components of this nation's housing delivery system. That we have become the best housed nation in the world is due in large part to the contributions of these two companies. With the help of Fannie Mae and Freddie Mac, nearly two-thirds of the nation’s households are homeowners. Much of this success is due to the public/private partnership established by Congress more than a half-century ago and to the reforms enacted in the Federal Housing Enterprises Safety and Soundness Act of 1992 (the GSE Act). This is not to say, however, that the current housing finance system is perfect. Indeed, several sectors of the housing market remain underserved by the present system. Until these gaps are filled, we cannot afford to be complacent. There is more work that the GSEs can and should be doing to expand homeownership opportunities to all Americans and to support the markets for affordable rental housing.

NAHB supports a strong and efficient regulatory system for Fannie Mae and Freddie Mac, one that balances safety and soundness concerns with mission fulfillment. We believe that the current GSE regulatory system meets these objectives. Nevertheless, Congress is right to periodically assess the current system and to examine changes to improve the system. In so doing, Congress should avoid enacting legislation that could impair the ability of Fannie Mae and Freddie Mac to perform their critical role in the housing finance system.

I. NAHB Comments on H.R. 1409

In the 106th Congress, this Subcommittee considered H.R. 3703, “The Housing Finance Regulatory Improvement Act of 2000.” H.R. 3703 proposed a two-track approach aimed at improving the regulation of the GSEs and changing their relationship to the federal government. The first track would have consolidated the regulation of all the housing GSEs, including the Federal Home Loan Bank System (FHLBS), into a new independent agency. The second track proposed a number of changes to the GSEs’ charters with regard to GSE status. In testimony dated July 20, 2000, NAHB expressed concerns that several provisions of H.R. 3703, particularly those relating to the regulator’s authority and changes to GSE status. We testified that enactment of such provisions, would disrupt the smooth operation of the US housing finance system by undermining the ability of the GSEs to provide liquidity and lower-cost financing, ultimately raising the cost of homeownership and rental housing.

H.R. 1409, introduced in this Congress, repeats the approach of H.R. 3703. With the exception that H.R. 1409 excludes the FHLBS, it is essentially the same as H.R. 3703. We are dismayed that the legislation ignores the extensive hearing record of the past year and the voluntary initiatives announced by Fannie Mae and Freddie Mac on October 19, 2000, regarding steps to strengthen market discipline, capital and liquidity. Indeed, H.R. 1409 has not resolved, and may have exacerbated, NAHB’s concerns with the prior legislation. We will confine our comments on H.R. 1409 to three provisions in the bill: consolidation of regulatory oversight in the Federal Reserve; approval process for new activities; and, changes to GSE status. As discussed below, NAHB believes that enactment of these provisions could have significant consequences affecting the availability and cost of housing for America’s homebuyers and renters.

Consolidation of Regulatory Oversight in the Fed

H.R. 1409 would consolidate the safety and soundness regulation of Fannie Mae and Freddie Mac by the Office of Federal Housing Enterprise Oversight (OFHEO) and the mission oversight by the Department of Housing and Urban Development (HUD) into the Federal Reserve Board. OFHEO would be abolished and HUD’s general regulatory authority over the enterprises would be terminated. The Fed’s principal duties with respect to Fannie Mae and Freddie Mac would be to ensure that the enterprises operate in a financially safe and sound manner, carry out their missions, and remain adequately capitalized. The Fed also would have general supervisory and regulatory authority over the enterprises. HUD would retain authority over affordable housing goals and Fair Housing Act responsibilities.

NAHB has several concerns regarding the proposed regulatory structure for Fannie Mae and Freddie Mac as set forth in H.R. 1409. First, we do not believe that consolidating the regulatory oversight of Fannie Mae and Freddie Mac into the Federal Reserve would improve regulatory efficiency. Prior to the 1992 GSE Act, all regulatory authority over Fannie Mae and Freddie Mac was vested in HUD. In the wake of the thrift crisis, Congress passed the 1992 GSE Act that created OFHEO as the safety and soundness regulator for the Enterprises and reaffirmed HUD as the program regulator. In so doing, Congress created a positive tension between the mission and safety and soundness oversight of these entities which has served the housing

market extremely well. It has focused the GSEs on their affordable housing mission, while establishing rigorous safety and soundness requirements. Any effort to consolidate these regulatory functions would be a step backward and would not improve on the current regulatory structure.

H.R. 1409 would result in a reduced emphasis on Fannie Mae's and Freddie Mac's housing mission. Regulation of how the enterprises carry out their affordable housing mission would be transferred from HUD, an agency focused on serving housing needs, to the Fed, an independent agency focused on bank regulation with no expertise in housing policy. The Fed is not the appropriate regulator for Fannie Mae and Freddie Mac. Although the Fed certainly is the pre-eminent banking regulator, it lacks the housing focus necessary to oversee Fannie Mae's and Freddie Mac's housing mission. Indeed, Fed Chairman Alan Greenspan has argued that Fannie Mae and Freddie Mac have fulfilled their Congressional mandate, thus the GSE status of these companies is no longer needed and is an unnecessary diversion of resources into housing. We take exception with this view and have expressed our concerns to Chairman Greenspan.

Transferring regulatory authority to the Fed also could result in a delay in the publication of final risk-based capital regulations for Fannie Mae and Freddie Mac. Implementation of such capital standards should be the highest priority to ensure the safety and soundness of the enterprises. We note that OFHEO is close to publishing its final risk-based capital rule applicable to Fannie Mae and Freddie Mac. This rule promises to be the toughest and most sophisticated of capital regulations in the financial services industry. NAHB has submitted comments to OFHEO in support of such a capital structure and we commend OFHEO for its work thus far. It is important that any consideration of restructuring the GSE regulatory framework not interfere in the development of these rules.

Review of New Activities

Section 106 of H.R. 1409 requires the Fed to approve new GSE activities and review ongoing activities. Currently, HUD is required to review new programs for Fannie Mae and Freddie Mac to ensure they are consistent with these GSEs' Congressional charters and are in the public interest. Under H.R. 1409, Fed approval would be required before the enterprises could begin a new activity. The bill defines new activity as any activity that is significantly different from or an expansion of previously approved programs and activities. A new activity could be approved only if it is authorized by law, if the Fed determines it can be conducted in a safe and sound manner, and it is in the public interest. The bill directs the Fed to establish procedures for obtaining new activity approval.

NAHB strongly believes that the GSEs should always operate within their Congressional charters. We believe that the GSEs have effectively identified market needs and responded efficiently. This is particularly true in the affordable housing area where both GSEs have introduced products and services to expand homeownership opportunities for low-and moderate-(low/mod) income borrowers, renters and residents of areas underserved by the broader housing finance system. Technological innovations by the GSEs, such as their automated underwriting systems (AUS), also have contributed to their efforts to expand homeownership opportunities. In the affordable multifamily market, both GSEs have established forward commitment programs

that support much-needed production of new units. Further, each has developed partnerships and alliances at the national and local levels to expand affordable housing opportunities. Several of NAHB's local Home Building Associations have worked with Fannie Mae and Freddie Mac on these partnerships.

NAHB is concerned that the prior approval process for new GSE activities envisioned in H.R. 1409 could adversely affect the ability of the GSEs to adopt programs such as these, preventing the companies from carrying out their housing missions. The prior approval language is so vague that any activity undertaken by Fannie Mae and Freddie Mac could be deemed "new" and require Fed approval through an undetermined process. We fear that the prior approval process could have a chilling effect on market innovation and impede the flow of new products and programs to meet new demands. Ultimately, we believe that this provision would hurt housing consumers.

Proposed Changes to GSE Status

Sections 109 and 110 of H.R. 1409 would change key federal privileges and legal exemptions provided to the enterprises in their federal charters. Section 109 of the bill would eliminate the exemption from SEC registration and reporting requirements. Section 110 would make use of the Treasury's line of credit with the GSEs -- the authority to purchase \$2.25 billion of Freddie Mac and Fannie Mae securities -- conditional upon a request from the Fed. Further, while the bill does not call for an outright repeal of the line of credit, as was proposed in H.R. 3703, other provisions direct the Treasury to study the GSE line of credit and the desirability of eliminating the line. These provisions effectively weaken Fannie Mae's and Freddie Mac's GSE status which provides the enterprises with their key benefit -- the ability to raise capital at rates that benefit homeowners and renters throughout the nation.

NAHB strongly opposes the withdrawal of any of the federal privileges and legal exemptions specified in the GSEs' charters, or any other actions that would dilute the GSE status of these institutions. There is nothing in the hearing record on H.R. 3703 that would support these provisions. Indeed, the consensus at the end of the hearing process was that the federal attributes in the GSEs' charters should not be repealed or modified. All of us are aware of what happened in the financial markets following the March 2000 hearing. These events are a clear demonstration of the importance of the financial market's perception of the GSEs and the potential for unintentional damage from possible changes to their GSE status. We urge Congress to carefully consider the consequences that changes to GSE agency status could have on the housing finance system and the cost of homeownership.

II. NAHB Comments on the CBO Study -- "Federal Subsidies and the Housing GSEs"

The Congressional Budget Office (CBO) made at least two attempts to estimate the implicit "subsidy" captured by the housing government sponsored enterprises, once in 1996 and again in 2001. The CBO studies analyze a number of important elements in the operation of Fannie Mae and Freddie Mac (the Federal Home Loan Bank System is also analyzed but that is not the subject of this comment) in order to show that they retain some of the value of their federal preferences. The 2001 CBO study estimates that Fannie Mae and Freddie Mac received

\$10.6 billion in federal subsidies in 2000, retaining about \$3.9 billion (37 percent) and passing along \$6.7 billion (63 percent) to mortgage borrowers in the form of lower mortgage rates.

While the analysis is complex and the estimation techniques are sophisticated, the underlying approach is very simple. CBO backs into the value of the federal preferences retained by Fannie Mae and Freddie Mac by estimating “wholesale” and “retail” advantages in mortgage borrowing and lending. The difference is assumed to be retained by the two corporations.

The “wholesale” advantage is calculated as the difference between comparable, private debt and Fannie Mae or Freddie Mac debt. The “retail” advantage is calculated as the difference between mortgage rates on conforming mortgages and non-conforming mortgages. Under this approach, CBO assumes that any difference in Fannie Mae’s and Freddie Mac’s cost of funds is due to their federal preferences. Likewise, any difference between conforming and non-conforming mortgage rates is the only portion of the preference passed to consumers. Neither of these assumptions is true and therefore the logic behind the CBO estimation procedures, however sophisticated, is flawed.

Fannie Mae and Freddie Mac borrow at lower rates than other private financial institutions because of their special federal status and because they are large, unique, and well run companies in competition with each other. The movement of funds from world capital markets to the US housing market is one of the most efficient and effective financial operations in the world. These two intermediaries have perfected the systems, procedures and pricing by experience and experimenting. Their debt is priced lower because of these efficiencies compared to other financial companies. They also deal exclusively in residential real estate mortgages, which have proven to be one of the safest long term investments. Other financial intermediaries have more diverse portfolios that make it difficult to compare directly. If Fannie Mae and Freddie Mac are unique and better than others at what they do, then the CBO approach attributes these efficiencies to federal preferences when they should be attributed to expertise, experience and uniqueness.

Fannie Mae and Freddie Mac are able to reduce mortgage rates because of their federal preferences. They are also required to focus a substantial amount of their business on priorities identified by HUD, including mortgages for low- and moderate-income home owners and rental apartments. Compelling Fannie Mae and Freddie Mac to perform these added functions is a direct consequence of their federal charter and preferences. But, lending to underserved markets is not the same as lending to the conventional, vanilla mortgage market and CBO does not account for this difference. In fact, by virtue of the CBO residual approach, the benefits accruing to low- and moderate income renters and owners is attributed to the corporation.

The CBO study develops and utilizes some sophisticated estimation techniques in order to arrive at their estimates of the differences between the GSEs and other financial institutions. Some of the assumptions made could be changed based on different views. However, these points become relatively moot when the calculations are used in a model that ignores two overarching issues – unique characteristics beyond the federal preferences and requirements to serve markets not served by the private marketplace.

Conclusion

NAHB has appreciated the opportunity to share our views on H.R. 1409 and the May 2001 CBO Study. We believe that the housing finance system works well due largely to the critical supports provided by the housing government-sponsored enterprises, Fannie Mae and Freddie Mac. NAHB opposes the withdrawal or modification of the federal privileges and legal exemptions specified in the GSEs' charters or any other actions that would dilute the financial market's perception of the GSE status of these institutions. We appreciate the Subcommittee's efforts to assess and seek improvements to the regulatory framework for the GSEs and we are interested in continuing to participate in this process as we move forward. Ultimately, NAHB believes that any regulatory regime for the GSEs must allow these institutions to fulfill their public missions to support the housing finance system in a safe and sound manner.