

# U.S. Puts Faith in Fannie, Freddie

*Firms, Once Hemmed In, Are Freed for Bigger Role In Aiding Mortgage Market*

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Federal regulators, in an effort to contain financial turmoil, are handing government-sponsored companies an even bigger role in propping up the mortgage market.

Officials affirmed yesterday that government-sponsored mortgage investors **Fannie Mae** and **Freddie Mac** will enjoy loosened capital requirements, allowing them to pile more mortgage securities onto their balance sheets. Fannie and Freddie could purchase an additional \$200 billion of mortgage securities, equivalent to about 10% of expected U.S. home-mortgage lending this year. The two also plan to raise new capital.

Meanwhile, a proposal on which regulators are scheduled to vote would allow the 12 regional Federal Home Loan banks to buy as much as an additional \$160 billion in mortgage-backed securities, people familiar with the matter said yesterday.

The moves could help keep interest rates low for home buyers. Rates on mortgages rise when investors in securities backed by such loans demand a premium to compensate for what they see as growing risks. Aggravating that problem, some financial institutions that hold mortgage securities have been dumping them to raise cash.

Early signs were favorable. Lou Barnes, a mortgage banker at Boulder West Financial Services, Boulder, Colo., said yesterday afternoon he could offer a 30-year fixed-rate mortgage, with no fees or "points" paid to reduce the interest, at 5.875%, down from 6% a day earlier and a high of 6.5% in late February.

The gap between interest rates on Treasury securities and mortgage bonds guaranteed by Fannie and Freddie—a key determinant of consumers' rates—shrank to around 2.78 percentage points yesterday afternoon from a 22-year high of 3.68 points on March 6, said Jim Vogel, an analyst at FTN Financial Capital Markets, Memphis, Tenn.

Investors welcomed the shrinking gap and news of a greater role for Fannie and Freddie. Fannie's shares rose 8.8% yesterday to \$30.71, while Freddie shares were up nearly 15% to \$29.90.

The federal government and Federal Reserve have been aggressive recently in combating the housing and financial crisis, including their role in saving Bear Stearns Cos. from a bankruptcy filing.

James Lockhart, director of the agency that regulates Fannie and Freddie, said the lower capital requirements should provide a major boost to the mortgage market.

Fannie and Freddie are likely to buy or guarantee 80% of all new home loans made this year, says Guy Cecala, publisher of Inside Mortgage Finance, a trade publication.

## Calming Down

The difference between yields on bonds backed by 30-year mortgages guaranteed by Fannie Mae and on five-year Treasury notes has shrunk.



Source: Deutsche Bank Securities

◆ **What's New:** Fannie Mae, Freddie Mac and federal home-loan banks are being tapped anew to prop up the mortgage market.

◆ **How It's Happening:** Looser capital requirements let the companies pile more mortgage-backed securities onto their balance sheets.

◆ **The Debate:** Critics warn the assets may lose value as defaults rise. Fannie's CEO calls it a "shopper's paradise" because some of the assets are at distressed levels.

Mortgages insured by the Federal Housing Administration or other government agencies will account for an additional 10% of the market, he expects. Last year, Fannie and Freddie's share was about 55%.

The Federal Reserve last week sought to stabilize the mortgage market by saying it would lend as much as \$200 billion in Treasury securities to bond dealers in return for mortgage-backed securities. That gives these securities only a temporary home at the Fed, while Fannie and Freddie typically hold the securities for the long term.

Regulators in the past few years have required Fannie and Freddie to hold 30% more capital than their usual minimum while they fixed problems with their accounting and risk controls, a process now viewed as virtually complete. That capital surcharge is now falling to 20%.

Under the lower surcharge, Fannie and Freddie must hold capital equivalent to 3% of the mortgages they own, down from 3.25%. That, plus additional adjustments on the capital required for loans guaranteed by the companies, frees up about \$6 billion in capital that can support \$200 billion in additional mortgage holdings.

Meanwhile, the companies have indicated they intend to raise similar amounts in new capital, probably by selling preferred shares. Details haven't been determined.

The home-loan banks, created by Congress during the Great Depression, are owned by more than 8,000 banks, thrifts and other financial institutions. They make loans, known as advances, to their owners.

Like Fannie and Freddie, the home-loan banks can borrow money globally on the strength of investors' belief that the U.S. government would stand behind them in a crisis.

The home-loan banks can hold mortgage-backed securities equal to three times their capital. Their regulator, the Federal Housing Finance Board, will vote soon on whether that should be increased temporarily to six times, people familiar with the matter said.

Fannie and Freddie, both also created by Congress, acquire home loans from lenders. They hold some of those mortgages as investments and sell others in the form of securities to other investors world-wide. Fannie and Freddie guarantee the securities.

During the housing boom, the Bush administration argued that the companies were taking on too much risk and performing some functions that should be left to purely private-sector firms. Now, though, the administration prizes the ability of Fannie and Freddie to raise money and buy mortgages in huge volumes.

"It is a complete defeat for the anti-GSE ideologues" in the Bush administration, said Kenneth Posner, an analyst at Morgan Stanley, using an acronym for government-sponsored enterprises.

Accounting scandals that erupted in 2003 and 2004 put Freddie and Fannie on the defensive. Now they are regaining some of their old swagger.

"Do a little examination and ask yourself, 'What do you think the housing market in the U.S. would look like without the GSEs now?'" Richard Syron, Freddie's chairman and chief executive, said at a briefing yesterday.

Fannie and Freddie face risks. They own or guarantee about 45% of all U.S. home mortgages outstanding and are highly vulnerable to a general rise in defaults and dropping home prices. They reported combined losses of about \$9 billion in the second half of 2007, and losses are expected to continue this year.

When Fannie and Freddie buy more mortgage securities, they raise their exposure to the risk of write-downs. "I think it's a huge gamble on the backs of the U.S. Treasury," said Sen. Mel Martinez (R., Fla.), a member of the Senate Banking Committee.

However, the companies also see an opportunity for profit, should the crisis pass and the securities now trading at distressed prices rise in value. "It's kind of a shopper's paradise right now," said Daniel Mudd, Fannie's chief executive officer.

Aside from buying mortgage securities, Mr. Mudd said Fannie will use its additional capital to buy or guarantee more loans that refinance distressed borrowers out of adjustable-rate mortgages, as well as to fund larger loans in high-cost areas. Congress recently gave Fannie and Freddie temporary authority to purchase loans of up to about \$730,000 in areas with the priciest homes.

While Treasury Secretary Henry Paulson supported yesterday's move, he said he remains frustrated that lawmakers haven't bolstered oversight of Fannie and Freddie.

—Greg Ip contributed to this article.