October 13, 2014

Federal Housing Finance Agency

Office of Strategic Initiatives, 400

7th Street, S.W., Washington,

D.C., 20024

**Via FHFA.gov**

 **Re: Proposed Single Security Structure**

To Whom It May Concern:

The Federal Housing Finance Agency (FHFA) has posted a Request for Input on “the proposed structure for a Single Security that would be issued and guaranteed by Fannie Mae or Freddie Mac.” The FHFA’s press release states that

The Single Security project is intended to improve the overall liquidity of Fannie Mae and Freddie Mac mortgage-backed securities by creating a Single Security that is eligible for trading in the to-be-announced (TBA) market. FHFA is requesting public input on all aspects of the proposed Single Security

structure . . . ..

The FHFA states it is most concerned with achieving “maximum secondary market liquidity” (Request for Input, at 8)

I am skeptical about the reasons for this move to a Single Security and whether it will achieve maximum liquidity. Moreover, it is unclear to me that this move reflects an urgent need for the FHFA, the two companies, originating lenders or borrowers. While I have no doubt that it could slightly increase liquidity and slightly decrease the cost of credit, I do not see this move as having a meaningful effect on either.

This move is consistent, however, with a move toward a new model of government-supported housing finance, one that could contemplate an end to Fannie and Freddie as we know them and the beginning of a more utility-like securitizer. If, indeed, the FHFA is taking this step, it should be more explicit as to its reasons for doing so.

In recent years, the federal government has insured or guaranteed 80-90% of new residential mortgages through its instrumentality, the Federal Housing Administration (FHA) as well as through Fannie Mae and Freddie Mac, for which the FHFA is the conservator. Some believe that the federal government is the only entity that can provide mortgage credit in a stable way and history is arguably on their side. Since the Great Depression, when the Home Owners Loan Corporation, the FHA and Fannie Mae were created, the federal government has had a central role in the housing finance market. Some also believe that there is not enough private capital to replace the government-guaranteed capital in the market even if there was sufficient political will to do so. Nationalization and quasi-nationalization proposals are just seen as the natural extension of this state of affairs.

Various scholars and think tanks have proposed versions of a nationalized or partially nationalized housing finance system with a utility-like securitizer at its heart. The bipartisan Johnson-Crapo housing finance reform bill contained aspects of a utility-like securitizer. This bill appears dead in the water, however, with Congressional reform not expected for years.

The FHFA’s common securitization platform is a step in the direction of nationalization, particularly while Fannie and Freddie are in conservatorship. This platform seeks to combine the back office functions of Fannie and Freddie into one entity. This approach gives up on the notion that the private sector should be in the lead position of evaluating and bearing the risk of loss from the underwriting of loans. This is inconsistent with what we know of how markets should work.

Generally, it is considered appropriate for the government to step into the market if there is a market failure. Market failures in the housing markets typically fall into two categories: those caused by excessive information costs and those caused by uninsurable risks.[[1]](#footnote-1) Given that market players have developed an extraordinary level of detail about borrowers (reduced to a simple FICO score) and homes (with mandatory appraisals), a market failure would have to result from uninsurable risks.

As noted, some have argued that there is not enough private capital to support the entire American mortgage market. Even if that were true, however, there is no theoretical reason why private capital should not be in a first loss position for large swaths of that market. As such, the FHFA should be focused on reducing the taxpayer’s exposure to credit risk in the mortgage markets not on creating a dominant government instrumentality like the common securitization platform. And it is important to remember what is at stake: if government funds are in the first loss position, then taxpayers are stuck holding the bag at the end of the next bust in the housing market.

The residential mortgage market we create today will likely be the one our grandchildren use. We have, at most, one chance to get it right. If the FHFA is going to take the lead in this area, it is incumbent on it to make its reasons for doing so explicit so that the American people are aware of the roads not taken on the journey toward homeownership.

*This response is drawn in part from previous writings of the author that can be found at* [www.REFinblog.com](http://www.REFinblog.com).

Sincerely,

David Reiss

1. David J. Reiss, *Landlords of Last Resort: Should the Government Subsidize the Mortgages of Privately-Owned, Small Multifamily Buildings?*, 32 Western New England L. Rev. 915, 940 (2010). [↑](#footnote-ref-1)