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A legal update from Dechert's Financial Institutions and Finance and Real Estate Practice Groups

## Administration Report Offers New Directions for the Federal Role in Housing Finance

The Obama Administration on February 11, 2011 released its report to Congress on reforming the nation's housing finance market. The report calls for an incremental wind-down of Fannie Mae and Freddie Mac, a scaled-back role for the U.S. government in the housing finance system and the creation of a finance market in which the private sector plays the dominant role in providing mortgage credit. The report also signals a move away from the notion that homeownership for all Americans should be a key government objective.

The Obama Administration's reform plan has three stated objectives: (i) pave the way for a robust private mortgage market by reducing government support for housing finance and winding down Fannie Mae and Freddie Mac on a responsible timeline; (ii) reform mortgage underwriting and mortgage securitization practices; and (iii) target the government's support to providing affordable housing for low- and moderate-income households, including through the creation of a new, dedicated, budget-neutral revenue financing source.

The report suggests making a gentle transition in the role that Fannie Mae and Freddie Mac play in the market, ultimately leading to their wind-down, by raising guarantee fees, increasing down payment requirements, reducing conforming loans limits and reducing their investment portfolios. The report acknowledges that the proposed reduction in government support for the housing finance market would be likely to reduce the availability and increase the cost of credit for housing.

The report sets forth three options for the long-term role of federal government guarantee support for the nation's housing finance system. None of the options would entirely end the government's role in the housing finance

system. Instead, each option would establish a hybrid system that, in varying degrees, would transfer much, but not all, of the government's role in the housing finance sector to the private sector.

- Option 1 would limit the government's role to insuring or guaranteeing loans offered through federal agency programs targeted at low- and moderate-income borrowers.
- Option 2 would provide the same targeted support as in Option 1, but includes a government backstop to ensure access to credit during a housing or general financial crisis. The backstop would have a minimal presence in the market during normal times, but could be scaled up as private capital withdrew in times of financial stress.
- Option 3 also would provide the targeted support described in Option 1. However, the government would act as reinsurer to qualifying private companies that guarantee securities backed by mortgages meeting strict underwriting standards. The government's reinsurance would protect investors in mortgage-backed securities and would pay out only after a qualifying private insurer or guarantor was entirely wiped out.

The report briefly summarizes the principal advantages and disadvantages of each of the options, but stops short of making any recommendations to Congress on which option ought to be adopted.

While the report focuses on high-level policy, there are significant legal considerations that will have to be decided as any reform plan moves toward fruition:

- The form and means of winding down Fannie Mae and Freddie Mac and how private equityholders will be impacted;
- Whether the array of reforms proposed in the report, including changes in lending standards, conforming loan limits, guarantee fees, affordable housing programs and mortgage servicing standards, limitations on junior liens and restrictions on Federal Home Loan Bank membership, lending and investment requirements, are pursued through legislation, regulation or otherwise; and
- Potentially increased fair lending focus and enforcement at both the origination and securitization levels.

Depending on how the recommendations and options contained in the report are implemented, there could

be significant changes in the nation's housing finance system and the mix of homeownership and rental housing. The Administration and the housing agencies have not yet coalesced to adopt a specific national housing policy, or direction with regard to Fannie and Freddie, and, given the stakes involved, no final actions are likely to be taken before the next Presidential election.

Given the importance of these issues to a wide range of potentially impacted industry sectors and the public at large, we can expect a great deal of legislative and regulatory attention being paid to the proposals and options set forth in the report.

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