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Quicktake Fannie Mae and Freddie Mac

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By Joe Light
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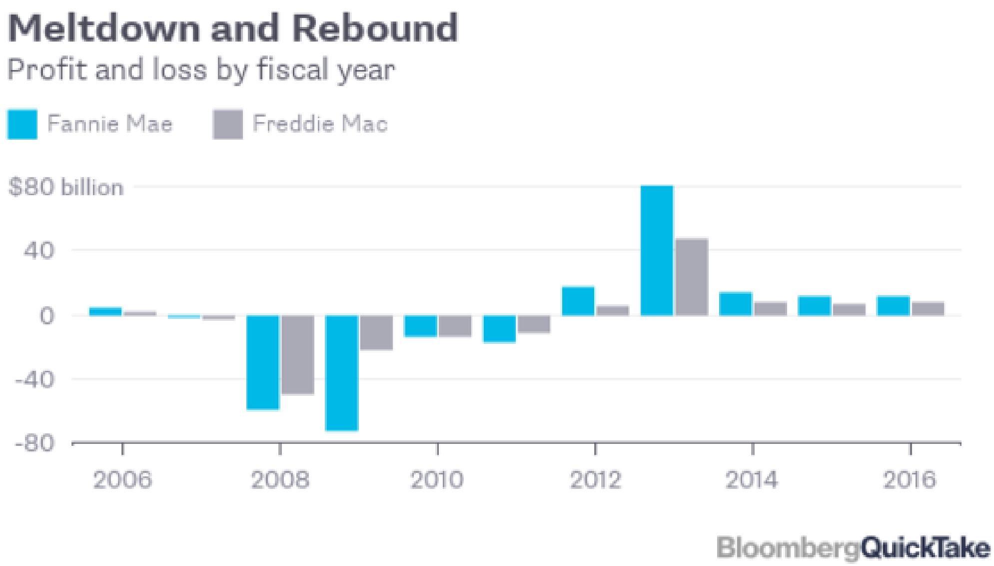
For decades, the mortgage giants Fannie Mae and Freddie Mac were the fat and happy foundation of the U.S. housing market. By buying and packaging home loans into bonds and absorbing much of their risk, they made it easier for homebuyers to get mortgages, and to get them on easier terms than are available in most countries. Created by the government and then spun off as shareholder-owned corporations, Fannie and Freddie churned out steady profits, as investors treated their debt as virtually risk-free. It was the best of both worlds – until the housing market melted down in 2008. The government's bailout of Fannie and Freddie cost $187.5 billion. Fannie and Freddie have more recently become hugely profitable, and the housing market is more dependent on them than ever.

The Situation

Lawmakers from both parties have worked on bills to overhaul the U.S. housing finance system, but it is considered unlikely that any of them will pass before the midterm elections in November. Meanwhile, Fannie and Freddie have been pouring money into the U.S. Treasury, which has received more than $278 billion in dividends from them since 2008. In March 2018, both companies took bailout money for the first time since 2012, prompted by the tax bill signed into law by President Donald Trump in December. That law cut the corporate tax rate, lowering the value of assets that Fannie and Freddie can use to offset taxes, which led to the losses. Fannie needed $3.7 billion, while Freddie took $312 million. The companies also remain embroiled in a number of lawsuits filed by investors over the huge payments to the government. The investors lost at the district and appeals court levels and in February the Supreme Court declined to hear one of the cases.



Sources: Fannie Mae, Freddie Mac

The Background

Congress created the Federal National Mortgage Association in 1938 as a government agency with a mission of reviving the mortgage market after its collapse in the Great Depression. Traditionally, banks that made mortgages held on to them. By buying mortgages from lenders, Fannie Mae, as it became known, freed up money that the banks could use to make more loans. After World War II, that process helped fuel a housing boom and made 30-year fixed-rate mortgages the American norm – in most other countries mortgages have shorter terms or adjustable rates. In 1968, Congress converted Fannie into a for-profit, shareholder-owned company, in part to ease a debt burden fueled by spending on the Vietnam War. Freddie Mac, the Federal Home Loan Mortgage Corporation, was created as a federally-chartered corporation in 1970 to give Fannie Mae some competition. It was turned into a publicly traded company in 1989. The companies helped the market for mortgage-backed securities grow by guaranteeing the payments of bonds it sold – bonds that many investors treated as nearly as safe as those of the U.S. Treasury, because of what was seen as an implicit government guarantee. That meant the companies could borrow more cheaply than other lenders. Some conservative economists say their collapse was caused by Congressional requirements to back lending in poor areas. But most studies have pointed to their small capital reserves and decision to expand their investments in loans packaged by Wall Street during the housing boom, including subprime bonds. Fannie and Freddie now stand behind about half of new U.S. mortgages, compared with about a third in 2005.

The Argument

Since 2008, most of the plans put forward in Congress involved shrinking the amount of mortgage-credit risk backstopped by the government and winding down Fannie and Freddie. That idea has prompted opposition from affordable housing groups and small lenders. But any plan that involves a substantial government guarantee might not win over conservatives. A less ideological issue is whether to compensate shareholders who were wiped out when the government seized the companies in 2008. Investors in the companies include several prominent hedge funds.

The Reference Shelf

- The takeover of Fannie and Freddie was addressed in the U.S. Financial Crisis Inquiry Report and a study by the Federal Reserve Bank of New York.
- The terms of the bailout agreement between the U.S. Treasury Department and Fannie Mae and Freddie Mac.
- A 2014 Bloomberg story about an attempt at legislation to wind down the companies. The legislation died later that year.
- A Bloomberg article about Fannie and Freddie shareholders' battle for a share of the companies' profits
- A federal judge's 2014 decision to dismiss shareholder complaints alleging the government illegally took Fannie Mae's and Freddie Mac's profits.
- An April 2016 audio recording of oral arguments of shareholders' appeal of the dismissal.

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In this article

FNMA
FANNIE MAE
1.64 USD ▼ -0.11 -6.29%

FMCC
FREDDIE MAC
1.60 USD ▲ +0.00 +0.00%