

# Fannie, Freddie Backstop May Foreshadow Mortgage Forgiveness

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*Business Week*  
*December 28, 2009*

The U.S. Treasury Department's expansion of its capital backstops for Fannie Mae and Freddie Mac may foreshadow a shift in the government's mortgage- modification tactics, Keefe, Bruyette & Woods analysts said.

The Treasury announced Dec. 24 that the two mortgage- finance companies, which were seized by the U.S. almost 16 months ago, could tap an unlimited amount of capital for three years, up from as much as \$200 billion each. The companies' needs would be unlikely to exceed the prior limits "even in a stress case scenario," Bose George and Jade Rahmani, the New York-based analysts, wrote in a report today.

"Given this outlook, we believe that the main driver of this significant change is the flexibility it gives the government to take more aggressive action to support the housing market, including potentially going down the road of allowing some form of principal writedown," the analysts wrote.

Under the Obama administration's Home Affordable modification program, loan servicers reduce borrowers' payments to 31 percent of their pretax incomes through means starting with interest-rate cuts. The program, which is meant to curb soaring foreclosures, doesn't reduce the size of homeowners' debt, even with more than one-fifth owing more than the value of their properties, according to Seattle-based Zillow.com.

Shifting to principal forgiveness to cure so-called negative equity that makes borrowers more likely to abandon loans whose payments they can afford may prove more costly for Washington-based Fannie Mae and Freddie Mac of McLean, Virginia, by sparking "another wave of delinquencies as people look at it as a rational choice" to default to seek the aid, George said in a telephone interview.

The larger backstop would be available to protect against the "moral hazard issue," he said.

## *Second Mortgages*

A change in tactics in the U.S. modification program is needed as the "current version has been a failure," in part because of trouble in getting the necessary documents from homeowners, George said.

Dealing with second mortgages, which aren't owned by Fannie Mae and Freddie Mac, would be "essential" to any move to principal forgiveness, though "I don't know what the solution to that will be," he said.

Through November, servicers had permanently modified 31,382 mortgages under the Home Affordable program, which was announced in February as targeting 3 million to 4 million loans, the Treasury said Dec. 10. A total of 728,000 of the modifications were under way.

Fannie Mae has tapped \$60 billion of its lifeline so far and Freddie Mac has been provided with \$51 billion.