

Fannie, Freddie Messy Government Tie Tough to Cut

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NEW YORK (Reuters) - With the housing sector still on the ropes, the Obama administration on Tuesday will begin to sketch out plans for the market's two biggest financing pillars, Fannie Mae and Freddie Mac.

After hitting its worse slump since the Great Depression, the housing market is being very slowly resuscitated by the government with massive dollops of cash and the help of Fannie Mae and Freddie Mac.

The government has relied on the companies, which combined guarantee nearly half of all outstanding mortgages, to mop up bad loans in a bid to help struggling homeowners. Along the way, the government was forced to take control of the two firms, at a cost to taxpayers that has reached \$125 billion so far.

Adding to their woes, some Republican lawmakers have blamed Fannie and Freddie for causing the housing bubble and credit meltdown, and have called for the elimination of the two, which were chartered by Congress to provide liquidity to the housing market and foster affordable housing.

"I do not see the government stepping away from Fannie and Freddie," said Peter Demirali, portfolio manager at Cumberland Advisors in Vineland, New Jersey. "For all intents and purposes they've been nationalized except in name only."

Treasury Secretary Timothy Geithner on Tuesday is expected to lay out the Obama administration's broad vision for restructuring the mortgage finance giants in congressional testimony.

Geithner has said that any specific legislative proposals will not come until 2011 at the earliest. His testimony before the House Financial Services Committee on Tuesday is expected to be the first step in a long journey to revamp the existing housing finance system.

Talk is also heating up that Fannie and Freddie could play pivotal roles in the Federal Reserve's efforts to drain \$1 trillion in excess bank reserves it pumped into the banking system during the credit crisis and recession.

There is little doubt that Fannie and Freddie will come under fire at the hearing, but it is unclear whether harsh rhetoric will spell the beginning of the end of the two GSEs given their deep reach in the U.S. financial system.

And after Sunday's divisive passage of healthcare reform, analysts say there is no political urgency from President Barack Obama to overhaul the housing system.

"The administration wants to postpone any changes in Fannie Mae and Freddie Mac until next year at the earliest," said Jim Vogel, a strategist at FTN Financial in Memphis, Tennessee.

INVESTORS WATCHING

The investment community, holding \$3 trillion in debt issued by Fannie Mae and Freddie Mac and the mortgage-backed securities they guarantee, has a huge stake in the companies' future.

On top of that, the Federal Reserve itself is close to wrapping up purchases of \$1.25 trillion in mortgage-backed securities backed by the two companies, which was part of the central bank's efforts to hold down home loan costs and to boost the economy.

Overseas central banks also held \$773 billion in agency securities last week, according to the latest Fed data. "Too much debt is held by foreign central banks and sovereign wealth funds for the federal government to basically say, 'We're not going to support them,'" Cumberland's Demirali said.

An erosion in confidence in Fannie and Freddie could end up hurting the United States' own credit standing because it has opened up the checkbook to cover them over the next few years.

Rating agencies have warned the United States' coveted AAA debt rating could be endangered if it doesn't put its fiscal house in order over the next years.

Still, this messy tie between the government and the companies will unlikely be dissolved soon, if ever.

"They are intertwined and it's becoming deeper and deeper," said Demirali.

(Editing by Leslie Adler)