M E M O R A N D U M

To: Members, Committee on Financial Services

From: FSC Majority Committee Staff

Date: June 7, 2013

Subject: June 12 Full Committee Hearing titled "Beyond the GSEs: Examples of Successful Housing Finance Models without Explicit Government Guarantees"

The Committee on Financial Services will hold a hearing on "Beyond the GSEs: Examples of Successful Housing Finance Models without Explicit Government Guarantees" at 10 a.m. on Wednesday June 12, 2013, in Room 2128 of the Rayburn House Office Building. This will be a one-panel hearing with the following witnesses:

- Dwight Jaffee, Willis Booth Professor of Banking, Finance, and Real Estate, Haas School of Business, University of California Berkeley
- Michael Lea, Director, The Corky McMillin Center for Real Estate, San Diego State University
- Alex J. Pollock, Resident Fellow, American Enterprise Institute
- Lawrence J. White, Robert Kavesh Professor of Economics, Stern School of Business, New York University
- Dem Witness TBD

This hearing will examine the mortgage finance systems of other countries to determine whether a sustainable system of housing finance is possible that does not rely on government-sponsored enterprises or government subsidies. This hearing will also examine examples of housing finance in the United States that have occurred outside the purview of the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac.

U.S. Housing Finance: The GSE Model

For almost 40 years, Fannie Mae and Freddie Mac have dominated the U.S. mortgage market, thanks to the advantages they enjoyed as GSEs. By 2008, the U.S. housing bubble had collapsed and the GSEs survived only because they were bailed out by U.S. taxpayers and taken into conservatorship. Nonetheless, despite their failure, the GSEs' dominance of the U.S. mortgage market has increased: in the first quarter of 2013, the GSEs guaranteed 75% of all single-family mortgages that were securitized. The outsize role that the GSEs play in the U.S. mortgage market has led some commentators to suggest that the U.S. mortgage market cannot function without them.

Yet it is the U.S. model that is the anomaly: no other developed country in the world has a government-sponsored enterprise similar to Fannie Mae or Freddie Mac.

How the U.S. Housing Market Measures Up

Proponents of the GSE model of housing finance often assert that the costs of that model are justified because it provides benefits that no other countries enjoy. But notwithstanding all the resources and subsidies that the GSEs have diverted towards housing finance, when compared to the rest of the world, the U.S. ranks in the middle of the pack on any number of criteria.

Home Ownership

GSE proponents often argue that the GSE model has given the U.S. higher rates of home ownership than other countries. But the reality is that even though the U.S. has a relatively high rate of home ownership, it is not the highest among major developed countries. The U.S. home ownership rate is 65%, and it rates 17^{th} in the world, after Australia, Ireland, Spain, and the United Kingdom, all of which provide far less government support for home ownership than does the United States.

Mortgage Rates

GSE proponents also argue that the GSE model makes housing more affordable by lowering interest rates for borrowers. Yet from 1998 to 2009, the U.S. had the sixth highest average mortgage interest rate when ranked against 15 countries in Western Europe, and mortgage interest rates in the U.S. were 22 basis points higher than the average for Western Europe. The higher rates that U.S. borrowers paid for mortgages suggest that despite the GSEs' dominance in the U.S. housing finance system, they failed to lower mortgage rates.

Mortgage Defaults

Other countries that do not rely on the GSE model appear to have weathered the housing crisis better than the United States did. Professor Dwight Jaffee has written that "the most dramatic difference between western Europe and the United States is in the foreclosure rate." At year-end 2009, the U.S. foreclosure rate was 4.58 percent for all mortgages and 3.31 percent for subprime mortgages; the foreclosure rate for subprime mortgages was 15.58 percent. By contrast, Spain and the United Kingdom—two of the most distressed countries in Europe—had much lower foreclosure rates: 0.24 percent and 0.19 percent respectively.

Why the Difference?

Housing finance in the United States evolved from a policy choice in which the federal government bears most of the mortgage credit risk, allowing investors to manage interest and pre-payment risk. As a result of this policy choice, housing finance in the U.S. is unique in several ways: it has the highest level of government involvement in housing finance in the world, which has resulted in a higher level of securitization and the dominance of the long-term fixed rate mortgage. In addition, mortgages in the U.S. are typically non-recourse, and lenders are largely prohibited from charging pre-payment penalties.

While some supporters of the current system point to these features as benefits of that system, the failure of the GSEs and the costs borne by taxpayers and homeowners have led some to wonder whether those benefits are worth the cost. Housing finance systems in other countries suggest that it is possible to offer consumers more choices at lower costs, without requiring taxpayers to bear credit risk or interest-rate risk, while still allowing a robust mortgage market and high rates of home ownership.

Examples Here at Home

While other nations have demonstrated that housing finance can thrive without GSEs or government guarantees, the experience of the U.S. mortgage market also shows that housing finance need not be dependent on GSEs. For example, even though the U.S. mortgage market has long been dominated by the GSEs, Professor Jaffee notes that the U.S. mortgage market also provides significant evidence that housing finance can be done without relying on GSEs or government guarantees. Professor Jaffee points out that private markets have originated 100 percent of U.S. mortgages; thus, shuttering the GSEs would not affect mortgage origination. Moreover, the GSEs' share of mortgage-backed securities did not exceed 30 percent until 2007, prompting Professor Jaffee to conclude that "private markets—depository institutions and capital market investors—are capable of holding or securitizing the large majority of U.S. mortgages."

The market for Jumbo mortgages—mortgages that exceed the GSEs' conforming loan limits and are therefore not eligible for purchase by them—offers further evidence that housing finance can succeed without the GSEs. Dean Baker of the Center for Economic and Policy Research writes that "the private market can provide housing finance without any direct support from the government. This is demonstrated by jumbo mortgages, which typically carried a premium of 25-50 basis points above conformable mortgages."

If you have any questions, please contact Ed Skala, Michael Ahern, or Frank Medina at x 5-7502.