## CASE: FANNIE MAE-FREDDIE MAC

I. RATIONALIZATION /JUSTIFICATION:

ACTORS: FANNIE MAE, FREDDIE MAC, GOVERNMENT, OTHER COMPANIES WITHIN THE MARKET, TAXPAYERS, RECIPIENTS,

PROBLEM: PRIVATIZATION VS. FEDERAL SPONSORSHIP (W/IMPROVEMENTS)

RISKS INVOLVED:
1) DISRUPTION IN HOME MORTGAGE MARKETS AND ITS EFFECTS ON INTEREST RATES AND ACCESS TO CREDIT.
2) EFFICIENCY OF CREDIT ALLOCATION

CONSTRAINTS:

1) FINANCIAL :

a) increase in rates of interests undermine capacity to credit access.
b) increase in risk calification
c) existence of $1.9 billion subsidy out of federal budget.
d) federal charters restrict line of business (support secondary market)

2) ECONOMICAL:

a) public purpose vs. profit (shareholders. taxpayers)
b) distribution of income vs. market .
c) federal support to these companies had represented an unprecedented increase in the liquidity and accessibility to mortgages market for low to moderate income people.

3) POLITICAL:

a) the social sense of stability and accessibility to moderate interest rates.
b) the impossibility to quantify some of the contributions made by these companies to low to middle class families and the social mobility.
c) the level of the salary packages of top executives and the retention amount are ripening the issue before the eyes of policymakers.
d) federal mandate: to increase the rate of homeownership specially in the low income class.
e) on-going new approach to lower class families could be reverted if privatization decision were adopted.

CAPACITIES: 1) The enterprises had the capacity to achieve their main purposes
2) Their administrative capacity to survive within a competitive environment remains unknown. But it is clear that the level of operating has been mitigated by federal charters.
3) Market conditions have changed since these enterprises were founded (other enterprises participate successfully in the provision of liquidity in secondary markets)
4) high technical capacity (day by day operations)

## II. COMPLICATIONS

Fannie Mae and Freddie Mac working with lower operating costs and higher risk califications have a determinant advantage over other possible participants in the activity. This has lowered competition in the market. (entry costs?)

Without Federal sponsorship (i) cost of home mortgage credit, (ii) 'efficiency 'in the market and (iii) affordable housing activities could be affected.

Conflict of Political Interests: efficiency in the market vs. public policies objectives

Conflict of Public Interest Allocation (political mandates vs. market driven principles)

## III. ALTERNATIVES

1) Privatization:
a) Pros: elimination of the subsidy and transparency achievement; more efficiency in the market (effect on liquidity and stability of the market, mortgage interest rates)
b) Cons: small increase in mortgage interest rates (new participants in the market could mitigate this) ; affordable housing activities.

2) Extending the current situation (adding new activities to Fannie Mae) :
a) Pros: continuity on a strategy that has demonstrated success in its expansion; expansion of housing goals;
b) Cons: Preserving the discrepancies on the quantification and level of the federal government funds;

3) Transitional Program to reduce the government benefits they receive: to privatize in a specific time-frame, in order to implement a certain process intended to eliminate the federal sponsorship. It is conceived as a step-by-step program. Some alternatives to take

under consideration my be: changing the conforming loan limit in order to direct more squarely the GSEs' objectives; requiring the GSEs. to direct a portion of its earning to specific issues (low income sectors, education, provision of information, etc.); ending certain benefits like exemption from SEC fees.