



Navigating the Turbulent Mortgage Marketplace



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What exactly is going on with Fannie Mae and Freddie Mac?

Fannie Mae was created in 1938 as a government agency with a mission to buy mortgages from banks and issue bonds on the bond market using the pool of mortgages as collateral for the bonds. This process was designed to add liquidity to the mortgage marketplace and supply banks with extra funds that could be used to allow more Americans to buy and own homes. Fannie Mae became so successful and profitable that in 1968, the government decided to spin it off into a private, shareholder-owned company. In 1970, the government chartered Freddie Mac as another shareholder-owned company to provide some competition to Fannie Mae and further provide liquidity, stability and affordability to the housing market. Since then, the companies have grown so large that they own or guarantee roughly half of all mortgages in the United States.

Recently, Fannie Mae and Freddie Mac have been experiencing a crisis of confidence in the financial markets. The main fear right now is that Fannie and Freddie will be unable to continue to access short term funding that is required for them to continue their normal business operations. Financial institutions count on short term loans and lines of credit to engage in their business activities – please reference the article in this series entitled " *What exactly is the problem today with banks, financial institutions and the financial markets?*"

In other words, there is a fear that Fannie and Freddie will experience a "run" on their business similar to what happened with Bear Stearns in March 2008. With this in mind, the Fed and US Treasury Department are proposing that Congress officially give them the authority to step in and rescue Fannie and Freddie if they can no longer get funding from the open market. The main argument in favor of this strategy is that it would cause the market to relax and resume doing business with Fannie and Freddie as normal because of the unlimited express backing of the US government. If Fannie and Freddie have an unlimited line of credit with the government, doing business with them would be equivalent to doing business with the US government. They might never need to tap the government line of credit because its mere existence would inspire confidence among the other players who do business with them. It's kind of like a school boy who brings his daddy to the playground with him on every school day – no one would dare mess with him!

The main concern with this scenario is that it is not a sustainable long-term strategy to have US taxpayers support the risky business practices of for-profit companies like Fannie Mae and Freddie Mac. Interestingly enough, Fannie and Freddie do not wish to be completely privatized. Their preferred status and ties to the government has resulted in record corporate profits when times are good and a taxpayer-funded safety net when times are bad. However, just because the companies engage in business that benefits the public doesn't mean that they deserve to be fully backed by taxpayers and the federal government. After all, many other businesses also benefit the public such as food service companies, energy companies, auto and transportation businesses, etc. It is not the mission of the government to rescue for-profit businesses when they run into financial problems.

With that in mind, many individuals and institutions have called for completely privatizing Fannie and Freddie and eliminating their ties to the government. Breaking up the companies and completely privatizing them may very well be a viable long-term solution and prevent a crisis of this magnitude from occurring in the future. Nevertheless, it is also important to prevent the current credit crisis from creating a full-scale meltdown of the US housing market and financial system - which is exactly what would happen if Fannie and Freddie were to blow up. The key is to weather the current crisis without sowing the seeds of the next one.



Quick facts about Fannie Mae and Freddie Mac

- Spent over \$170mm on government lobbying activities since 1998
- Current market share is 68% of all new US home mortgages compared to 45% one year ago
- Own or guarantee nearly half of all US home mortgages outstanding - this represents approximately \$5 trillion worth of home loans

Please ask me about other articles in this series:

- What exactly is the problem today with banks, financial institutions and the financial markets?
- How long will the turmoil last, and is this still a good time to buy a home?
- What are the options if I owe more on my mortgage than the value of my home?

Conclusion:

It is always advisable to consult with a Certified Mortgage Planning Specialist™ (CMPS®) when navigating today's turbulent mortgage and real estate marketplace. As a CMPS® professional, I am committed, qualified and equipped to help you evaluate your options!

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