GOVERNMENT HOUSING POLICY AND THE FAILURE OF THE GSES

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Abstract

United States government policies supporting homeownership do not actually help low- to moderate-income earners when government-sponsored for-profit enterprises implement those policies. Viewed through the lens of the financial crisis of 2008 and the effects of property ownership on psychological and physical well-being, the benefit of lowering mortgage underwriting standards through Government Sponsored Enterprises (GSEs) and the Community Redevelopment Act (CRA) in order to increase homeownership is outweighed by costs imposed on individual homeowners and the economy as a whole. Therefore, if the assumption is that homeownership is a desirable outcome for the American people, and that homeownership is a goal worth promoting through the U.S. government, these goals should be implemented solely through government agencies, and the U.S. government should abandon the GSE model.

Section I presents a brief overview of the issues presented in this note. Section II outlines the history of the GSEs from their creation in the aftermath of the Great Depression to their operation around the turn of the century. Section III discusses the three main approaches developed by scholars utilized in understanding the relationship between government policy implementing affordable housing goals and the GSEs' role in the financial crisis. Section IV reviews sociological research into the benefits of homeownership and discusses the relationship between those purported benefits and economic stability. Finally, Section V contends that policy-makers must examine whether the GSEs serve a purpose in modernity that could not be satisfied by means of other mechanisms that the government uses to implement affordable housing. The author suggests that if legislators determine that the GSEs do remain a useful policy tool, that nationalization of the entities would serve the dual function of maintaining the GSEs as a productive means of implementing affordable housing policy while reducing the systemic risk that aggravated their role in the financial crisis.

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I. Introduction

U.S. government policies throughout most of the twentieth century shaped the development of the secondary market for mortgages when the private sector was unable and unwilling to invest after the Great Depression.[1] "The secondary mortgage market channels funds to borrowers by facilitating the resale of mortgages and mortgage-backed securities (MBSs). In that market, lenders such as banks, thrifts, and mortgage companies obtain funding for the loans they originate by selling the loans to purchasers such as Fannie Mae, Freddie Mac, and other financial institutions . . . ."[2] Initially, underwriting standards for the underlying loans sold on the secondary market were stringent, reflective of the risk-averse decades following the Great Depression.[3] As time continued, however, the private sector became the driving force of the secondary mortgage market[4] and GSEs became viewed as dated and unprofitable.[5] Consequently, when Congress passed the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (GSE Act), which demanded that GSEs re-examine their underwriting standards,[6] the GSEs were only too happy to comply so

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[1] Christopher L. Peterson, *Fannie Mae, Freddie Mac, and the Home Mortgage Foreclosure Crisis*, 10 LOY. J. PUB. INT. L. 149, 149, 152-53 (2009) ("For nearly sixty years following the Great Depression, the federal government was the primary architect and sponsor of a secondary mortgage market infrastructure that shaped the contours of American housing finance.").

[2] CONG. BUDGET OFFICE, PUB. NO. 4021, FANNIE MAE, FREDDIE MAC, AND THE FEDERAL ROLE IN THE SECONDARY MORTGAGE MARKET, at vii (2010).

[3] Peterson, *supra* note 1, at 154.

[4] *Id.* at 160.

[5] *Id.* at 162 ("Critics of the GSEs complained that Fannie and Freddie only purchased 'vanilla' loans based on relatively conservative and strict automated underwriting systems.").

[6] 12 U.S.C. § 4601 (2012) ("Each of the enterprises shall conduct a study to review the underwriting guidelines of the enterprise. The studies shall examine—(1) the extent to which the underwriting guidelines prevent or inhibit the purchase or securitization of mortgages for housing located in mixed-use, urban center, and predominantly minority neighborhoods and for housing for low- and moderate-income families; (2) the standards employed by private mortgage insurers and the extent to which such standards inhibit the purchase and securitization by the enterprises of mortgages described in paragraph (1); and (3) the implications of implementing underwriting standards that—(A) establish a downpayment requirement for mortgagors of

that they could regain their controlling position in the secondary mortgage market.[7] The result was heavy GSE investment into non-traditional mortgages (NTMs), justified by GSE efforts to increase the availability of affordable housing.[8] Thus, the effects of government housing policy throughout the twentieth century was to create a stable secondary mortgage market, but then to undermine this stability through overconfidence in the U.S. economy and by GSE investment into risky mortgage-backed securities (MBSs).

The U.S. government's affordable housing polices could have contributed to the financial crisis of 2008 in at least three ways. First, it is possible that the lack of sufficient regulation over GSEs led to GSEs loosening underwriting standards and purchasing risky loans in order to become more profitable, and that this activity was not sufficiently regulated because GSEs were performing in-line with affordable housing goals.[9] Second, it has been suggested that GSEs themselves did not lower underwriting standards too far, but that in a

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5 percent or less; (B) allow the use of cash on hand as a source for downpayments; and (C) approve borrowers who have a credit history of delinquencies if the borrower can demonstrate a satisfactory credit history for at least the 12-month period ending on the date of the application for the mortgage.").

[7] FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 178 (2011).

[8] Peterson, *supra* note 1, at 163 ("In 2003 Fannie and Freddie used both their direct mortgage purchasing programs and their ability to purchase investments for their retained portfolio to quietly take aggressive positions in the—at that time—highly profitable private label subprime and alt-A mortgage markets. Although purchasing risky securities had never been the mission of the two special companies, management justified this significant shift in their method of and standards for acquiring mortgage loans by explaining that the investments were profitable and furthered their mission of providing support for home ownership."); EDWARD J. PINTO, GOVERNMENT HOUSING POLICIES IN THE LEAD-UP TO THE FINANCIAL CRISIS: A FORENSIC STUDY 29 (Discussion Draft 2/5/2011) ("Over the next 5 years Fannie would develop and begin implementing a strategy to use its low- and moderate-income housing mission as the means to 'protect the franchise'. Fannie would use copious amounts of low- and moderate-income housing lending to capture its regulator, Congress, in an effort to assure that Congress would not change its charter privileges to its detriment.").

[9] Andra C. Ghent, Rubèn Hernández-Murillo, & Michael T. Owyang, *Did Affordable Housing Legislation Contribute to the Subprime Securities Boom?* 36 (Research Div. Fed. Reserve Bank of St. Louis, Working Paper 2012-005D).

deregulated environment, GSEs were drawn into the MBS market by the private sector, which was filling the vacuum left by GSEs in the NTM market and engaging in risky lending practices.[10] Third, regulatory actions that loosened underwriting standards in order to promote affordable housing goals may have directly caused the increase in risky lending practices.[11] In reality, the likelihood is that all three of these narratives are partially true, and that government housing policy contributed to the financial crisis by loosening underwriting standards and by regulatory failure to stop GSEs from purchasing risky MBS packaged by the private sector.

Social research and psychology revolving around the concept of self-realization and the impact of home ownership on psychological health and political participation suggests that homeownership has a powerful correlative effect on the well-being of low- to moderate-income earners.[12] The benefits of homeownership, however, may revolve primarily around the stabilizing influence on homeowners' lives.[13] Consequently, when government policies encouraging homeownership result in volatility for individuals and for society as a whole, those policies that were meant to be beneficial instead become detrimental for low- to moderate-income earners.[14] Therefore, when making policy decisions regarding affordable housing, the U.S. government must not only take into consideration its aspirational goals, but consider the real effects that occur on the ground, especially in light of the foreclosure crisis seen in our most recent economic crash.

Government policies clearly play an important role in the development of stability in the housing market. A historical perspective shows that government intervention after the Great Depression created standardized lending practices that allowed slow and safe economic growth.[15] However, it is also clear that the gray area that GSEs occupied around the turn of the century, quasi-private

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[10] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 178.

[11] PINTO, *supra* note 8, at 29.

[12] *See* discussion *infra* Part IV.A.

[13] NAT'L ASS'N OF REALTORS, SOCIAL BENEFITS OF HOMEOWNERSHIP AND STABLE HOUSING 7 (2012) *available at* http://www.realtor.org/sites/default/files/social-benefits-of-stable-housing-2012-04.pdf [https://perma.cc/97AW-XHCB].

[14] *Id.*

[15] *See* discussion *infra* Part II.A. (discussing the role of GSEs after the Great Depression and their stabilization of the mortgage market).

and quasi-public, created a disconnect between government policy goals and profit motivation.[16] In execution, these quasi-entities were subject to quasi-regulation, which led to oversights that could have prevented the financial crisis from, at the very least, reaching the magnitude that it did.[17] This note suggests that, although not the direct cause of the financial crisis, government policies intended to increase homeownership were a significant contributing cause. Thus, in order for affordable housing policy to actually help produce stability for low- to moderate-income earners, the regulatory regime should operate in a purely government-regulated sphere, and do away with the quasi-public, quasi-private model of GSEs.

II. Effects of U.S. Government Housing Policies on Mortgage Underwriting Standards

During the twentieth century, GSEs set the standard for mortgage underwriting and lending practices.[18] Over the course of the decades following the Great Depression, GSEs were able to exploit their special charters and standing as quasi-governmental agencies to command the secondary mortgage market and become titans of the industry.[19] Due to their success in the wake of the Great Depression, by the turn of the century, GSEs were in a unique position because of their history of strong and successful performance and long-standing relationship with the federal government. But as the new century rolled in, the traditional safeguards to moral hazard were left behind, and GSEs were engulfed in the tide of risky lending practices. Because of the GSEs' special position in the market and the implicit guarantee of the U.S. government, their position became more and more precarious, and the GSEs were especially vulnerable when the market crashed.

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[16] *See* discussion *infra* Part II.B.

[17] *Infra* notes 84-93 and accompanying text.

[18] *Infra* notes 20-42 and accompanying text.

[19] *Infra* notes 40-42 and accompanying text (showing link between GSE charters and a competitive edge in the mortgage market); David Reiss, *Fannie Mae and Freddie Mac and the Future of Federal Housing Finance Policy: A Study of Regulatory Privilege*, 61 ALA. L. REV. 907, 910 (2010) ("The two companies effectively have no competition in the conforming sector of the mortgage market because of advantages granted to them by the federal government in their charters. The most significant of these advantages has been the federal government's implied guarantee of Fannie and Freddie's debt obligations.").

A. The Great Depression

In the 1930s, in the wake of the Great Depression, the federal government enacted a wave of reactionary regulation, establishing a series of banks and agencies to stimulate the stagnant economy.[20] In 1934 Congress established the Federal Housing Administration (FHA), which was "tasked . . . with offering federally guaranteed insurance to private home mortgage lenders."[21] Four years later, still unsatisfied with the state of the housing market, "Congress created Fannie Mae to . . . buy up mortgages that met federal underwriting guidelines and public policy objectives."[22] The GSEs were established by Congress as "privately owned financial institutions . . . ."[23] This meant, that while the GSEs were not "officially backed by the federal government. . . . most investors believed that the government would not allow the GSEs to default on their obligations."[24] This implicit federal guarantee largely contributed to investor feelings of security in investing in the secondary mortgage market after the Great Depression.[25]

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[20] Peterson, *supra* note 1, at 152-53 ("Fannie Mae and Freddie Mac are products of the financial trauma, lessons learned, and market infrastructure produced by the Great Depression. . . . Eventually the federal government seized control of the secondary mortgage market in an attempt [sic] induce home mortgage lending. Federal efforts unfolded in a series of initiatives and agencies that ultimately led to the creation of Fannie Mae, and later Freddie Mac. These efforts began during the Hoover administration, when Congress created the twelve regional Federal Home Loan Banks (FHLBs)."); A. Mechele Dickerson, *The Myth of Home Ownership and Why Home Ownership is Not Always a Good Thing*, 84 IND. L.J. 189, 193 (2009) ("The Federal Housing Administration (FHA) was created during the Depression to help stimulate the housing market. . . . Congress also chartered Government-Sponsored Entities (GSEs) to help stabilize U.S. residential mortgage markets, ensure the efficiency and liquidity of the mortgage market, and generally expand opportunities for home ownership.").

[21] Peterson, *supra* note 1, at 154.

[22] *Id.*

[23] CONG. BUDGET OFFICE, PUB. NO. 4021, *supra* note 2, at viii.

[24] Peterson, *supra* note 1, at 154.

[25] *Id.*

The FHA and GSEs initially adhered to stringent underwriting policies.[26] These underwriting policies, along with the implicit government backing of the GSEs, were essential to the stimulation of interest in reinvestment because the policies minimized risk through rigorous lending criteria at a time when investors, still reeling from the Great Depression, were extremely risk-adverse.[27] This reactionary regulation in the secondary mortgage market was vital to jump-starting the housing market when banks stopped lending during the Great Depression.[28] And although the housing crisis continued into the 1930s, regulation slowly encouraged capital markets to reinvest in mortgages.[29]

By the 1960s, the economy had substantially recovered but government initiatives surrounding affordable housing had not slowed.[30] Congress created Ginnie Mae to continue with Fannie's original function of purchasing government insured mortgages,[31] and Fannie "became a private federally chartered corporation whose primary function would be to purchase conventional home mortgages from private lenders."[32] Congress also created Freddie Mac in order to supplement the efforts of Fannie Mae.[33] The Housing and Urban Development Act of 1968 further empowered Fannie to issue and sell MBSs.[34] The 1970s saw continuing developments in the new and

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[26] *Id.* at 154, 157.

[27] *Id.* at 157 ("Because the agencies still guaranteed the principal and interest income of their securities even when mortgagors defaulted, investors saw the securities as a low risk investment . . . .").

[28] *Id.* at 155.

[29] *Id.* at 154-55.

[30] *Id.* at 156; Charles J. Abrams, *Fannie and Freddie Flipped: A Backward Induction Analysis of the GSEs' Meltdown*, 3 WM. & MARY POL'Y REV. 157, 158 (2011).

[31] Peterson, *supra* note 1, at 156 ("In 1968 Congress partitioned Fannie Mae into two separate organizations. The first organization retained the original function, but operated under a new name: The Government National Mortgage Association. 'Ginnie Mae,' as it became known, continued to purchase nonconventional FHA and VA insured mortgages.").

[32] *Id.*

[33] *Id.* ("In 1970, Congress created 'Freddie Mac' to serve a similar role as Fannie Mae.").

[34] Abrams, *supra* note 30, at 158 ("In an effort to provide even greater liquidity to the market, Section 1719(d) of the Housing and Urban Development (HUD) Act of 1968 conferred upon Fannie the power to issue and sell mortgage-backed securities (MBS).").

exciting market for securitized loans.[35] GSEs began dabbling in pass-through investment vehicles and more complex MBSs.[36] Investors were thrilled as these securities were diverse, and seen as low-risk; not only did the GSEs maintain strict underwriting guidelines, but they maintained the implicit backing of the U.S. government.[37] The GSEs would not purchase unusually large mortgages, variable interest rate mortgages, or subprime mortgages, adding to the relative safety of investing in their MBSs.[38]

As a result of continuing government attention, business was booming for the GSEs by the 1970s, and the issuances of MBSs further stimulated capital markets and the growth of the GSEs.[39] Growth was further facilitated by the fact that although there was no explicit federal backing of the GSEs, investors still "regarded Fannie and Freddie bonds as functionally indistinguishable from Treasury bonds on the theory that the two GSEs were 'too big to fail.'"[40] The market created by the GSEs had successfully created a safe

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[35] Peterson, *supra* note 1, at 158.

[36] *Id.* at 156-57 ("A short time later, a new method of obtaining funds for mortgage loans developed: securitization. Rather than holding mortgages themselves, both Ginnie Mae and then Freddie Mac began issuing mortgage-backed securities that 'passed through' interest income to investors. The agencies would purchase home mortgages, deposit large numbers of them in 'pools,' and sell participations in the pools to investors on Wall Street. With these new pass-through investment vehicles, investors could hold a share of large (and diversified) numbers of mortgages insured by the government in the case of Ginnie Mae, or guaranteed by the large stable government sponsored enterprises (GSEs) in the case of Freddie Mac and Fannie Mae (who also began securitizing shortly thereafter).").

[37] *Id.* ("Because the agencies still guaranteed the principal and interest income of their securities even when mortgagors defaulted, investors saw the securities as a low risk investment even without the assurances of a rating organization, such as Standard and Poor's or Moody's.").

[38] *Id.* at 158 ("Moreover, because the GSEs invested in mortgages with specific middle class oriented policy objectives in mind, they would not purchase unusually large ('jumbo') mortgages, mortgages with variable interest rates, home equity loans, or—most importantly for our purposes—subprime mortgages.").

[39] *Id.* at 157.

[40] *Id.* at 156.

investment environment that investors were eager to enter.[41] The GSEs had standardized the mortgage market.[42]

Although the GSEs were initially hesitant to invest in subprime loans, the private sector was not.[43] By the 1980s and 90s, private sector investment in NTMs was booming; the new generation of investors were less risk averse, and wanted to create new types of investment vehicles.[44] With the private expansion of the market for MBSs, however, came increased risk.[45] When the private sector

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[41] *Id.* at 157.

[42] Reiss, *supra* note 19, at 914 ("Because Fannie and Freddie have so dominated the conforming sector of the mortgage market, they have standardized that sector by promulgating buying guidelines that lenders must follow if they want to sell their mortgages to either of the two companies.").

[43] Peterson, *supra* note 1, at 158-59 (In 1977, Bank of America and Salomon Brothers (with some limited cooperation from Freddie Mac) moved to take advantage of these potential markets by issuing a security where outstanding loans were held in trust, with investors as beneficiaries. The trust itself was entirely passive—it had no employees or assets aside from the home mortgages themselves. Participations in these trusts are generally recognized as the first mortgage-backed securities issued by the private sector-now called 'private label' mortgage-backed securities.").

[44] *Id.* at 159-60 ("In particular, investment banking firms developed pricing models that allowed prospective investors to anticipate the value and liquidity of private-label mortgage backed securities. Investment banks also began partitioning risk into different investments types with a variety of credit risks, all drawing on the same income stream from a pool of mortgages. Where earlier residential mortgage backed securities would merely pass through income to investors, tranched securities divided payments into different income streams suited to the time and risk preferences of investors. Thus, investment bankers learned to tailor securities to the needs of different investors, making investment in mortgage-backed securities desirable to a broader range of potential investors.").

[45] *Id.* ("Eventually, private label, subprime mortgage backed securities were typically offered in tiers of credit risk where pool income was distributed to the highest risk profile (usually with the highest possible rating) first, and would then 'waterfall' down to each subsequent subordinated risk tier. The lowest risk tier, called an "equity piece," would absorb all losses before the next level absorbed any loss at all."); FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 42 ("Securitization 'was diversifying the risk,' said Lindsey, the former Fed governor. 'But it wasn't reducing the risk. . . . You as an individual can diversify your risk. The system as a whole, though, cannot reduce the risk. And that's where the confusion lies.'").

developed models to allow prospective investors to more accurately evaluate the value of MBSs, a false sense of security arose.[46] Tranched securities were understood to further mitigate risk by allowing investors to choose the level of risk they wished to take on.[47] However, these securities were merely packaged differently, they did not reduce the systemic risk the market was experiencing as a whole.[48] With this huge expansion of investment into NTMs, the private sector captured a large market share from GSEs.[49] While the economy continued to grow, GSEs played less of a role in the secondary mortgage market.[50]

This progression from Depression to healthy market and relatively safe underwriting and investment practices to more risky investment into NTMs was a slow process. While in the early twentieth century government policies set the stage for the secondary mortgage market and established underwriting standards that allowed for safe investment, by around the turn of the century, the secondary mortgage market had evolved into a completely different type of market.[51]

B. Turn of the Century

As the American economy recovered from the Great Depression and grew rapidly, the private sector, willing to take greater risks, largely took the reins controlling the secondary mortgage market from GSEs.[52] At the same time the private sector was expanding, it was clear, with some help from Congress, that by the late twentieth century legislative goals relating to housing policy had evolved.[53] Depression-era fears had eroded and the legislature

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[46] Peterson, *supra* note 1, at 159-60; FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 42.
[47] Peterson, *supra* note 1, at 159-60.
[48] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 42.
[49] Peterson, *supra* note 1, at 160.
[50] *Id.*
[51] *See* discussion *supra* Part II.A. (discussing the evolution of the GSEs up until the 1990s).
[52] *Supra* notes 43-50 and accompanying text.
[53] Peterson, *supra* note 1, at 159 ("Without such a method, mortgage-backed securities suffered from liquidity problems and were accordingly artificially undervalued. Eventually, the market, along with some help from Congress in the mid-1980s, succeeded in developing financial tools to overcome these hurdles."); Dickerson, *supra* note 20, at 196 ("To respond to the

saw a strong economy that was able to help implement nationwide homeownership as a policy goal.[54]

In 1992 Congress passed the Federal Housing Enterprises Financial Safety and Soundness Act, also known as the GSE Act.[55] The GSE Act required GSEs to re-examine their underwriting standards,[56] gave HUD power to set affordable housing goals for GSEs,[57] and set numerical targets for GSE investment in mortgages of low- to moderate-income earners.[58] Historically, GSEs had not participated in facilitating affordable housing goals; these goals were primarily implemented through the FHA.[59] However, Congress and public interest groups felt that the FHA was not doing enough to help low- to moderate-income earners, so GSEs were pulled in through the GSE Act as another mechanism to help low- to moderate-income earners purchase homes.[60]

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unaffordability problem, the U.S. government encouraged mortgage originators to diversify their loan products.").

[54] Dickerson, *supra* note 19, at 196 ("Until foreclosure rates started to rise in 2006, many homeowners had experienced unprecedented home price appreciation. Housing prices in the aggregate increased by more than fifty percent and, in some regions, housing prices increased annually by over ten percent. Though housing price appreciation created vast sums of wealth for some homeowners, the gains have been unevenly distributed, and the gains for some created an unaffordability problem for others. To respond to the unaffordability problem, the U.S. government encouraged mortgage originators to diversify their loan products.").

[55] Abrams, *supra* note 3034, at 162 n.28.

[56] 12 U.S.C. § 4601 (2012).

[57] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 41.

[58] Ghent, Hernández-Murillo, & Owyang, *supra* note 9, at 7.

[59] PINTO, *supra* note 8, at 3 ("Congress had long used HUD and its loan guarantee arm, FHA (created in 1934), as its main tools to provide low- and moderate-income housing. However, in 1990 two budgetary changes made it more difficult for Congress to expand low- and moderate-income housing through HUD and FHA. . . . As a result of these provisions, Congress had to find another means if it wanted to significantly expand financing for low- and moderate-income housing. Fannie and Freddie filled the bill perfectly.").

[60] *Id.* at 3-4 ("National People's Action (NPA) and ACORN, along with other community and consumer advocacy groups concluded that Fannie and Freddie's underwriting requirements were to blame for the failure of the Community Reinvestment Act of 1977 (CRA) to gain traction. . . . By the early 1990s NPA, ACORN and other groups were dissatisfied with the perceived pace of change and were concerned that Fannie, Freddie, and

In 1995, CRA regulations were revised to be more outcome-based.[61] The CRA required that banks engaged in more flexible lending, as compared to their competitors, which effectively forced banks to lower underwriting standards, as without large enough CRA commitments, they were unable to effectuate mergers.[62] Banks that did meet CRA requirements were able to grow into larger and larger institutions, thus the very banks that engaged in the riskiest lending were those banks that rapidly became too big to fail.[63]

At the same time, HUD agreed to allow GSEs to "get affordable housing credit for buying subprime securities . . . ."[64] GSEs began purchasing more MBS from third parties[65] and investment into subprime mortgages continued to grow.[66] HUD guidelines thereby incentivized significant GSE investment into the subprime MBSs that CRA requirements simultaneously encouraged banks to pump out into the market.[67]

Throughout the late nineties, government pressure to expand the scope of mortgage loans continued.[68] In 1995, the Clinton

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lenders 'still viewed them as "special programs" and have not incorporated them into standard underwriting practices.' Having gotten CRA passed in 1977, NPA, ACORN, and other community groups appealed to Congress in 1991 to force change at the GSEs.").

[61] *Id.* at 69; Raymond H. Brescia, *Part of the Disease or Part of the Cure: The Financial Crisis and the Community Reinvestment Act*, 60 S. C. L. REV. 617, 634-35 (2009).

[62] PINTO, *supra* note 8, at 69 ("Large banks desiring an "outstanding" rating needed to outperform their competitors. Since virtually all large banks desired an outstanding rating in order to facilitate merger approvals, a game of leapfrog ensued.").

[63] *Id.* at 70 ("CRA helps promote "too big to fail institutions" by rewarding banks that loosened their underwriting standards with the ability to consummate mergers.").

[64] *Id.* at 73.

[65] Peterson, *supra* note 1, at 162 ("Prior to 1997, the two companies purchased relatively few mortgage backed securities from third parties. However, since then, both Fannie Mae and Freddie Mac drastically increased their purchases of private label mortgage backed securities.").

[66] Dickerson, *supra* note 20, at 206; Reiss, *supra* note 19, at 940.

[67] *See supra* notes 61-66 and accompanying text (stating that the CRA effectively forced banks to engage in risky lending practices that resulted in risky MBS, which GSEs invested in with permission from HUD).

[68] *See infra* notes 69-73 and accompanying text (suggesting that executive policies continuously broadened affordable housing goals); PINTO, *supra* note 8, at 6 ("As house prices continued their unprecedented climb and

administration released its National Homeownership Strategy, which raised the affordable housing goals of GSEs.[69] By 1997 the GSEs had effectively entered the private market for MBSs in full swing and began investing in much larger amounts of privately-issued securities than they had before.[70] In addition, the FHA and GSEs began competing for loans to low- to moderate-income earners, resulting in investment into riskier and riskier loans.[71]

This momentum continued into the 2000s, when the Bush Administration's anti-regulation philosophy allowed GSE management to operate more like the private sector.[72] Congress was largely influenced by GSE lobbyists, guaranteeing that GSE charters remained unchanged, and allowing for continued minimal capital requirements for GSEs.[73] These low capital requirements allowed

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delinquency rates stayed in relative check, both Presidents Clinton and George W. Bush relied on weakened underwriting standards to expand homeownership.").

[69] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 41.

[70] Peterson, *supra* note 1**Error! Bookmark not defined.**, at 162.

[71] Reiss, *supra* note 19, at 929 ("A number of studies have indicated that Fannie and Freddie actually cannibalize the Federal Housing Administration (FHA) loan market by lending to borrowers who would have otherwise received FHA mortgages."); PINTO, *supra* note 11, at 53 ("The GSE Act effectively requires the 'A' paper or Prime market (largely consisting of the GSEs and banks) to compete with the two high risk areas of market—FHA and subprime.").

[72] Peterson, *supra* note 1, at 163 ("In 2003 Fannie and Freddie used both their direct mortgage purchasing programs and their ability to purchase investments for their retained portfolio to quietly take aggressive positions in the—at that time—highly profitable private label subprime and alt-A mortgage markets. . . .These changes occurred against the backdrop of the Bush administration's ideologically driven opposition to virtually any regulatory oversight of any kind."); Dickerson, *supra* note 20 at 193 ("Moreover, when housing became unaffordable for many lower- and middle-income renters, the George W. Bush administration encouraged the real estate and financial sector to increase product innovation to help renters (especially minorities) become homeowners and supported efforts to approve a zero down payment FHA loan program."); PINTO, *supra* note 8, at 6.

[73] Peterson, *supra* note 1, at 165 ("Congress' desire to promote homeownership translated into thin capitalization requirements where 'banks that held $100 could spend $90 buying mortgage loans, Fannie Mae and Freddie Mac could spend $97.50.'"); PINTO, *supra* note 8, at 4 ("Fannie Mae decided in 1986 to give up its government charter and become a

GSEs to operate with extremely high leverage ratios, placing them in a vulnerable position when the housing bubble burst.[74] Capital cushions disappeared and by 2007, Fannie and Freddie were leveraged at 75:1.[75]

Now in the wake of the most recent financial crisis, it is evident that over the course of the fifty years leading up to the financial crisis, legislative and executive goals that promoted home ownership as embodying the American dream and suggesting that low- to moderate-income earners should have access to buying opportunities went too far. While an admirable goal, lawmakers were either solely interested in short-term gain, or naïve in believing that the American economy could continue unimpeded growth and thus did not implement adequate safeguards on GSEs, such as capital requirements and sufficient underwriting standards. At the same time, the legislature encouraged risky private lending practices through the CRA. The result was a reduction of underwriting standards and heavy enough GSE investment into risky MBSs that GSEs were extremely vulnerable when the housing market crashed.

III. Housing Policy and the Financial Crisis

Scholars have suggested many reasons for the financial crisis, and it would be unwise to assume that there was a single over-arching cause.[76] Three arguments have arisen in relation to affordable housing goals and the role of GSEs in the crisis: (1) not enough regulation due to the implementation of affordable housing

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private company. This decision was quickly reversed in 1987 when it was decided that its funding advantages and implicit government guarantee under its charter were too valuable to surrender. Instead it would turn its focus to protecting its charter franchise privileges. Over the next 5 years Fannie would develop and begin implementing a strategy to use its low- and moderate-income housing mission as the means to 'protect the franchise'. Fannie would use copious amounts of low- and moderate-income housing lending to capture its regulator, Congress, in an effort to assure that Congress would not change its charter privileges to its detriment.").

[74] Peterson, *supra* note 1, at 165.

[75] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 65 ("Combined, Fannie and Freddie owned or guaranteed $5.3 trillion of mortgage-related assets at the end of 2007 against just $70.7 billion of capital, a ratio of 75:1.").

[76] *See* discussion *infra* Part III (discussing various positions on the cause of the financial crisis in relation to the GSEs).

goals and affirmative action by GSEs leading to systemic risk,[77] (2) not enough regulation due to the implementation of affordable housing goals and GSEs being drawn into the private market, rife with systemic risk,[78] and (3) too much regulation due to the implementation of affordable housing goals which actively reduced underwriting standards, thereby creating systemic risk.[79] It would be far too complicated to trace the exact intricacies of how government policies actually affected GSEs and the private market, however, it is useful to examine each of these arguments to understand how affordable housing policies implemented by the United States legislature may have contributed to the extent of the financial crisis, if not its creation.

A. Failure to Regulate

If it was lack of government regulation that led to GSE and financial institution investment in NTMs and the loosening of underwriting standards, then government housing policy contributed to the financial crisis by failing to provide necessary regulatory barriers to risky lending practices. There is some evidence to support this, namely that the Office of Federal Housing Enterprise Oversight (OFHEO), the regulator in charge of GSE oversight, failed to adequately restrict GSE purchases of NTMs,[80] that regulators relied on OFHEO too much,[81] that the CRA was too discretionary,[82] and that regulators failed to adjust conforming loan principals to reflect the reality of the situation on the ground.[83]

First, there is evidence that OFHEO saw reports of increased purchases of risky loans, and did nothing.[84] OFHEO focused instead

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[77] *See* discussion *infra* Part III.A (discussing possible effects of deregulation of GSEs on the financial crisis).

[78] *See* discussion *infra* Part III.B (discussing the interaction between GSEs and the private market).

[79] *See* discussion *infra* Part III.C (discussing legislative action surrounding the GSEs that affirmatively increased systemic risk).

[80] *See infra* notes 84-87 and accompanying text.

[81] *See infra* note 88 and accompanying text (implying that Congress intentionally left the GSEs under-regulated).

[82] *See infra* notes 89-92 and accompanying text.

[83] *See infra* note 93 and accompanying text (indicating a disconnect between loan principal requirements and their practical implementation).

[84] Peterson, *supra* note 1, at 163 ("OFHEO, a relatively underfunded and weak regulator even in a climate amenable to oversight, was essentially

on operational problems, rather than risky investments.[85] OFHEO did not put the brakes on risky MBS purchases and GSEs were effectively "protected from market oversight regarding the quality of their MBS."[86] Because GSEs were meeting their affordable housing goals and OFHEO was reporting that they were in good financial condition, there was little concern over the need to regulate GSEs further.[87]

Second, Congress originally chartered the GSEs as exempt from SEC oversight and with very low capital requirements.[88] Because the system had worked for decades, regulators relied on OFHEO and were unconcerned about the possibility of risky investments and leverage ratios as GSEs were meeting affordable housing goals, even if they were under-regulated. Accordingly, regulators failed to recognize and deal with the increasing risky MBS in which GSEs were investing.

Third, the CRA "gave banks and their regulators broad discretion to carry out the CRA's goals."[89] Legislators failed to draft

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silent as the GSEs shifted investment into the controversial subprime and risky Alt-A private securities."); FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 123 ("OFHEO knew about the GSEs' purchases of subprime and Alt-A mortgage-backed securities. In its 2004 examination, the regulator noted Freddie's purchases of these securities. . . . But the regulator concluded that the purchases of mortgage-backed securities and riskier mortgages were not a 'significant supervisory concern,' and the examination focused more on Freddie's efforts to address accounting and internal deficiencies.").

[85] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 122 ("In 2004, Fannie and Freddie faced problems on multiple fronts. . . . Struggling to remain dominant, they loosened their underwriting standards, purchasing and guaranteeing riskier loans, and increasing their securities purchases. Yet their regulator, the Office of Federal Housing Enterprise Oversight (OFHEO), focused more on accounting and other operational issues than on Fannie's and Freddie's increasing investments in risky mortgages and securities.").

[86] Abrams, *supra* note 30, at 162-63.

[87] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 123; Ghent, Hernández-Murillo, & Owyang, *supra* note 9, at 36 ("For example, the GSEs affordable housing goals may have given the GSEs some political cover to purchase substantial quantities of PLMBS.").

[88] Abrams, *supra* note 30, at 161, 164 ("Unlike other firms, the federal guarantee eliminated worries about the companies failing due to an excessive debt to equity ratio. Fannie and Freddie took full advantage of the lack of capital requirements.").

[89] Brescia, *supra* note 61, at 619.

important exemptions, which left subprime lending unregulated by the CRA.[90] CRA regulations also only applied to depository institutions, which made up the majority of those who were engaged in subprime lending.[91] The CRA was thus unable to impact the majority of those who were engaging in subprime lending, non-depository institutions, so the regulation in effect was not broad enough.[92]

Finally, executive and legislative policies failed to raise GSE's conforming loan principal limits to keep pace with home values.[93] Too little principal left homes with no equity other than their vastly inflated worth. When the housing bubble burst, homes that had relied on their own worth as their only equity became worth much less than their mortgage, and individuals were unable to refinance in order to pay off their mortgages as they had expected.

In summary, the majority of GSE regulation came from OFHEO, which failed to focus on the risky investments that GSEs were buying into with greater frequency. Because GSEs were meeting their affordable housing goals and continued to run smoothly, no red flags were raised. The CRA left broad loopholes for non-depository institutions that allowed them to engage in under-regulated subprime lending, adding fuel to the fire. Government policies also explicitly failed to raise required GSE loan principals to accurately reflect the market, leading to further vulnerability. The weight of the evidence leads to the conclusion that, at least in part, the government failed to adequately regulate GSEs and instead focused too greatly on their affordable housing goals, without taking care as to their implementation.

B. The Private Sector

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[90] *Id.* at 627.

[91] *Id.* at 646 ("As described above, the federal bank regulators do not review the activities of non-bank lenders who are affiliated with covered institutions during the CRA examination process unless the covered institution asks for their affiliates' inclusion in that process."); Ghent, Hernández-Murillo, & Owyang, *supra* note 9, at 4.

[92] Brescia, *supra* note 61, at 645-46.

[93] Peterson, *supra* note 1, at 167 ("At the tum of the century, Congress and the Bush Administration chose not to gradually raise the GSE's conforming loan principal limits to keep pace with modest single family home values in several of the nation's most expensive and important housing markets.").

If subprime lending began in the private sector, it was due to the vacuum left by GSEs in the market, but GSEs soon followed suit in order to maintain profitability and meet their affordable housing goals.[94] GSEs had adhered to more stringent lending standards throughout their history, leaving an unoccupied niche for investment into NTMs.[95] The private sector filled this niche and began developing new types of investment vehicles, some of which were enormously profitable.[96] Because of their quasi-private nature, the GSEs were profit-driven, and naturally wanted a piece of the very lucrative NTM pie.[97] Coinciding with legislative and executive pressure for increased access to affordable housing, the movement towards investing in NTMs was justified by the GSEs on public policy grounds.[98]

Before the turn of the century, GSEs did continue to rely on some generally safer (as compared to the private sector) underwriting standards, [99] dominating the market for "vanilla" mortgages.[100] The GSEs were able to continue with these heightened underwriting standards because they continued to enjoy charter advantages which made it difficult for the private sector to compete.[101] Increasingly, the "private sector [became] anxious to regain [market] share after

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[94] *See* discussion *infra* Part III.B (discussing the growth of the private market for MBS and this growth's effect on the GSEs.).
[95] PINTO, *supra* note 8, at 111.
[96] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 117 ("The business of structuring, selling, and distributing this deal, and the thousands like it, was lucrative for the banks. The mortgage originators profited when they sold loans for securitization.").
[97] *Id.* at 178.
[98] Peterson, *supra* note 1, at 163.
[99] *Id.* at 161-62 ("Early on, Fannie Mae and Freddie Mac were not involved in the growing subprime mortgage market. Indeed, throughout the 1990s, industry insiders referred to loans that qualified for purchase by the GSEs as 'conforming' in order to highlight the differences between subprime loans and the prime market served by Fannie and Freddie.").
[100] PINTO, *supra* note 8, at 111.
[101] *Id.* ("Overcoming the GSEs' benefits of high leverage, low borrowing cost, and implicit government guarantee had proved insurmountable. It was not for lack of trying. Companies with 'AAA' ratings, such as GE Capital, Wells Fargo, AIG, and FGIC, had tried and failed. In general they found that their 'AAA' rating was insufficient as Fannie and Freddie's implicit government guarantee and resulting high leverage gave the GSEs a pricing advantage that they could not overcome.").

having been increasingly marginalized by GSEs . . . ."[102] In order to overcome this disadvantage, the private sector began investing in riskier NTMs, like Alt-A, ARMs, and subprime loans.[103] These types of loans were more dangerous for two reasons. First, these types of loans were novel, and the long-term consequences of investing in them and their effect on the markets would not be understood until much later.[104] Second, these loans increased systemic risk because they spread this novel and unknown risk broadly across the market.[105] The private sector also began engaging in new forms of securitization in the forms of CDOs and CDOs squared.[106] CDOs allowed the private market to more effectively compete with GSEs for investment funds because they repackaged risky loans, which would otherwise be unsellable, into marketable products, while still relying on the inherently risky mortgages they were securitizing.[107]

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[102] *Id.* at 145.
[103] *Id.* ("A risk-based capital regulatory structure that over-incented the creation of 'AAA' and 'AA' securities and helped spur the creation of CDOs and CDOs squared. After years of frustration, private MBS executions are finally able to compete with the leverage levels long enjoyed by the GSEs."); FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 6 ("The securitization machine began to guzzle these once-rare mortgage products with their strange-sounding names: Alt-A, subprime, I-O (interest-only), low-doc, no-doc, or ninja (no income, no job, no assets) loans; 2-28s and 3-27s; liar loans; piggyback second mortgages; payment-option or pick-a-pay adjustable rate mortgages. New variants on adjustable-rate mortgages, called 'exploding' ARMs, featured low monthly costs at first, but payments could suddenly double or triple, if borrowers were unable to refinance.").
[104] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 7.
[105] *Id.* at 7 ("Under the radar, the lending and the financial services industry had mutated. In the past, lenders had avoided making unsound loans because they would be stuck with them in their loan portfolios. But because of the growth of securitization, it wasn't even clear anymore who the lender was. The mortgages would be packaged, sliced, repackaged, insured, and sold as incomprehensibly complicated debt securities to an assortment of hungry investors.").
[106] PINTO, *supra* note 8, at 112.
[107] *Id.* at 113 ("CDOs and CDOs squared were a significant help to the private sector in leveling the leverage playing field versus the GSEs. The credit support for the 'AAA' and 'AA, tranches was provided by the lower rated and unrated tranches . . . . Increasing the yields to attract more buyers would have made private MBS less competitive as compared to Fannie and Freddie's MBSs. CDOs and CDOs squared solved this problem by allowing

By 2004, the private sector had "caught up with Fannie Mae and Freddie Mac in securitizing home loans."[108] Within a few years "Wall Street was securitizing one-third more loans than Fannie and Freddie."[109] As the private market engaged in riskier underwriting standards, a gap emerged between the profitability of GSEs and the private sector.[110] This led to the profit-seeking GSEs purchasing risky MBSs from the private sector,[111] so although the GSEs were engaged in less risky practices themselves, they were in effect "on the hook" for the underwriting decisions made by the private sector.[112] This heavy investment into NTMs was overlooked by regulators because OFHEO continuously found that the GSEs had adequate capital and asset quality.[113] Eventually, the GSEs themselves "relaxed their underwriting standards to purchase or guarantee riskier loans and related securities in order to meet stock market analysts' and investors' expectations for growth [and] to

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MBS issuers and underwriters to create additional 'AAA' and 'AA' tranches out of the lower rated tranches—at lower yields and without providing any new credit support. By creating CDOs from these harder to sell tranches, additional tranches of the more desirable 'AAA' and 'AA' securities were created. Since these had narrower spreads, private MBS became more competitive with the GSEs' MBS. In effect the newly minted 'AAA' and 'AA' CDO tranches were now backing the old 'AAA' and 'AA' private MBS tranches.").

[108] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 102.

[109] *Id.*

[110] *Id.* at 178.

[111] Peterson, *supra* note 1, at 167 ("Fannie and Freddie ultimately invested in these markets anyway; they just did so by purchasing private label mortgage backed securities issued by investment banks such as Lehman Brothers and Meryl Lynch, and large aggressive subprime lenders such as Countrywide.").

[112] *Id.* at 169 ("It is certainly true that Fannie and Freddie's poor investing decisions drew the federal government into one of many costly financial system bailouts. However, when proponents of unfettered private markets have asserted that the GSEs caused the financial crisis, they tend to omit the fact that the GSEs' crippling losses came from purchasing overvalued securities produced by *unfettered private markets*.").

[113] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 180 ("OFHEO, the GSEs' regulator, noted their increasing purchases of riskier loans and securities in every examination report. But OFHEO never told the GSEs to stop. Rather, year after year, the regulator said that both companies had adequate capital, strong asset quality, prudent credit risk management, and qualified and active officers and directors.").

regain market share . . . justifying their activities on the broad and sustained public policy support for homeownership."[114]

It is clear that, as profit-motivated entities, GSEs were pulled quickly towards investing in risky MBS, and such behavior was ignored by regulators.[115] While there is evidence that "GSEs participated in the expansion of subprime and other risky mortgages . . ." there is also evidence that "they followed rather than led Wall Street . . . ."[116] Unfortunately, whomever led the expansion into the subprime market, the result was that GSEs were left extremely vulnerable when the housing bubble burst.

C. Regulatory Action

If regulators loosened underwriting standards, then government housing goals can be said to have more directly contributed to the financial crisis. This argument, which points to government housing policy as greatly contributing to GSE investment in NTMs, is supported by some commentators, notably Peter Wallison, the author of one of the dissents to the Financial Crisis Inquiry Report[117] and "Edward Pinto, a resident fellow at the American Enterprise Institute who had served as chief credit officer at Fannie Mae . . . ."[118] Scholars that adhere to this approach suggest that GSEs actively took advantage of affordable housing goals in order to maintain their position in the market,[119] look to the GSE Act as poor legislative policy-making,[120] blame HUD requirements for

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[114] *Id.* at xxvi.

[115] *See supra* notes 110-113 and accompanying text (suggesting that profitability was a driving force in moving GSEs towards the MBS market).

[116] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at xxvi.

[117] *Id.* at 441.

[118] *Id.* at 448.

[119] Abrams, *supra* note 30, at 163 ("The aforementioned accounting scandals only exacerbated the need for desperate measures to retain influence: to salvage wavering Congressional support, Fannie and Freddie engaged in even riskier additional subprime lending to increase affordable housing and appeal to Congress' goal of facilitating the American Dream of homeownership."); PINTO, *supra* note 8, at 2.

[120] Abrams, *supra* note 30, at 165 ("In fact, Fannie and Freddie were permitted to circumvent restrictions on bank concentrations placed on other financial institutions, which enabled them to become undercapitalized."); PINTO, *supra* note 8, at 5 ("During the 15 year period after the passage of the GSE Act of 1992, trillions of dollars in ever more weakly underwritten

leading to excessive NTM investment,[121] and blame the legislature and federal courts for curtailing state regulation of the finance industry.[122]

Affordable housing goals were historically implemented by government agencies, but budget considerations led Congress to outsource some affordable housing goals to GSEs in the 1990s.[123] In 1992, "the GSE Act loosened the mortgage standards related to down payments and acceptable credit histories to further increase home ownership." [124] The GSEs, attempting to hold on to their advantageous government charter, happily engaged in loans to low- to moderate-earners in order to curry favor with Congress.[125] The GSE Act also set minimal capital requirements for GSEs, allowing them to "circumvent restrictions on bank concentrations placed on

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loans would first buoy and then capsize the housing market. This accumulation of NTMs overwhelmed a thinly capitalized and highly leveraged housing finance sector, whose high level of leverage was also the result of government policies. For example, Fannie and Freddie's minimal capital requirements were set by Congress in the GSE Act of 1992.").

[121] PINTO, *supra* note 8, at 103 ("HUD's desire for the GSEs' to 'further step up their support for affordable housing' essentially meant an increase in support for the Special Affordable Goals (low- and very low-income) and the Underserved/Geographically Targeted Goals. While the Low- and Moderate- income Goal increased by 8%, virtually all of it was the result of an increase in the Special Affordable Goal which increased from 14% to 20%, representing a percentage increase of 43%. As noted earlier, placing most of the increase in housing goals on the Special Affordable (low- and very low-income) category required the GSEs to reach much further down the demand curve. This necessitated a major expansion of their efforts to ease home purchase requirements by further lowering downpayments and developing other leverage increasing flexibilities.").

[122] *See infra* notes 133-135 and accompanying text (discussing the preemption of state regulation of mortgage lending).

[123] PINTO, *supra* note 8, at 3 ("Congress had long used HUD and its loan guarantee arm, FHA (created in 1934), as its main tools to provide low- and moderate-income housing. However, in 1990 two budgetary changes made it more difficult for Congress to expand low- and moderate-income housing through HUD and FHA. First, HUD and FHA were agencies of the federal government and included in the discretionary portion of the budget. . . . As a result of these provisions, Congress had to find another means if it wanted to significantly expand financing for low- and moderate-income housing. Fannie and Freddie filled the bill perfectly.").

[124] Abrams, *supra* note 30, at 162.

[125] *Id.* at 163; PINTO, *supra* note 8, at 2.

other financial institutions, which enabled them to become undercapitalized."[126] Undercapitalization led to the GSEs being highly leveraged, thereby increasing systemic risk.[127] Perversely, theses high leverage ratios also allowed the GSEs to maintain their competitive edge.[128]

Aside from the effects of the GSE Act, HUD played a significant role in raising "the GSEs' low- and moderate-income goal[s] . . . ."[129] By 2000, "GSEs' affordable housing goals were 67% higher than those in effect" five years before.[130] Heightened HUD requirements required GSEs to dig deeper for low- to moderate-earner loans, further relaxing underwriting requirements.[131] Agencies and regulators felt comfortable with GSEs holding NTMs and securitizing them because of the GSEs positive performance history in the past.[132] Accordingly, regulators may have relied too heavily on GSEs to effectively implement policy goals, and in doing so, relaxed regulatory standards too far.

Finally, the legislature in conjunction with the Supreme Court effectively preempted "state efforts to rein in abuses in the subprime market" through the National Bank Act.[133] In *Watters v.*

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[126] Abrams, *supra* note 30, at 165; PINTO, *supra* note 8, at 5.

[127] PINTO, *supra* note 8, at 5 ("This accumulation of NTMs overwhelmed a thinly capitalized and highly leveraged housing finance sector, whose high level of leverage was also the result of government policies. For example, Fannie and Freddie's minimal capital requirements were set by Congress in the GSE Act of 1992. The GSEs only needed $900 in capital behind a $200,000 mortgage they guaranteed—many of which by 2004-2007 had no borrower downpayment. In order for the private sector to compete with Fannie and Freddie, it needed to find ways to increase leverage. Lack of skin in the game promoted systemic risk on both Main Street and Wall Street.").

[128] *Id.* at 54 ("These new capital levels worked in tandem with the risk based capital requirements noted earlier . . . . For example, on a Fannie MBS, Fannie was required to hold capital of 0.45% and the bank buying the MBS to hold 1.6%, for total capital of 2.05% and a leverage ratio of 49:1. If the bank held the same loan in whole loan (not securitized) form in its portfolio, its capital requirement was 4% for a 25:1 leverage ratio. If the same loan was part of a private MBS, the capital required of a bank holding the MBS was 8% for a 12.5: leverage ratio.").

[129] *Id.* at 103.

[130] *Id.*

[131] *Id.*

[132] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at 123.

[133] Brescia, *supra* note 61, at 627.

Wachovia Bank, N.A., 550 U.S. 1 (2007), the Supreme Court held that pursuant to the National Bank Act, states could not regulate national banks or their subsidiaries in the business of mortgage lending.[134] By disallowing states to regulate mortgage lending, a powerful potential check was removed from the regulatory regime.[135]

Thus, it is possible that when Congress allocated some responsibility for affordable housing to a profit-motivated entity, they made a substantial error. It is likely that GSEs were not interested in promoting affordable housing as for-profit entities, but instead saw a chance to maintain their advantageous charter while simultaneously staying competitive in the growing market for NTMs. When the legislature and agencies actively loosened underwriting standards and capital requirements for GSEs, it may have created a perfect storm of risky investment within highly leveraged institutions.

IV. Benefits of Homeownership

The socio-economic benefits of homeownership have long been a popular topic of discussion. This is unsurprising as the U.S. government has frequently promoted homeownership as one of the key building blocks of the American Dream.[136] Empirical research has shown that there is correlation between homeownership and a

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[134] Watters v. Wachovia Bank, N.A., 550 U.S. 1, 21 (2007) ("The NBA is thus properly read by OCC to protect from state hindrance a national bank's engagement in the 'business of banking' whether conducted by the bank itself or by an operating subsidiary, empowered to do only what the bank itself could do. . . . The authority to engage in the business of mortgage lending comes from the NBA . . . as does the authority to conduct business through an operating subsidiary. . . . That Act vests visitorial oversight in OCC, not state regulators.").

[135] Brescia, *supra* note 61, at 651-529 ("In the words of one state attorney general, however, the decision to preempt state predatory lending laws, as endorsed by the Court, 'took 50 sheriffs off the beat at a time when lending was becoming the Wild West.'").

[136] Dickerson, *supra* note 20, at 189 ("Home ownership is said to be a fundamental part of the American Dream because of the economic security it gives homeowners. The United States has long encouraged people to buy their own homes and has subsidized programs and activities that are designed to bridge the gap between renting and owning a home.").

number of desirable social and psychological factors.[137] These benefits, however, disappear in the face of instability and economic uncertainty.[138] Accordingly, it is unclear whether government housing policies around the turn of the century actually accomplished their goals of affording low- to moderate-earners with the opportunity to reap the benefits of homeownership, and policy-makers ought to consider carefully the long term impacts of setting affordable housing policy in light of the recent financial crisis.

A. Homeownership and Social Benefits

It is unquestionable that homeownership is a powerful positive force for individuals, so the federal government is likely justified in promoting affordable housing. There is evidence that homeownership results in feelings of increased self-worth, improves the lives of children, has an effect on political and community participation, and even has physical benefits.[139] It is a worthy goal of a government with the resources to attempt to equalize the ability of its people to benefit from these positive effects.

Indeed, even before data from social research was available, political philosophers have recognized property ownership as a "fundamental aspect of democracy and political freedom . . . ."[140] Many of the founders of the United States "expounded on the interdependent, and often reinforcing relationships among property ownership, economic autonomy, and political freedom."[141] "For many, the ownership of property is in itself perhaps the greatest expression of, and requisite for, freedom . . . . [because] with legal protection, an owner of property [is] secure enough to challenge those in power and less fearful of government reprisal."[142] With such notions deeply founded in philosophical roots propounded by Aristotle, Locke, and Mills, it is no wonder that the founders thought

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[137] *See* discussion *infra* Part IV.A (discussing research surrounding the benefits of homeownership).
[138] *See* discussion *infra* Part IV.B (discussing economic stability as foundational to creating the purported benefits of homeownership).
[139] *See* discussion *infra* Part IV.A (discussing research surrounding the benefits of homeownership).
[140] Geoffrey D. Korff, *Reviving the Forgotten American Dream*, 113 PENN ST. L. REV. 417, 421 (2008).
[141] *Id.* at 422.
[142] *Id.* at 423.

that that property ownership was foundationally important to a modern democracy.[143] And now, in the era of social research and empirical analysis of social issues, there is evidence that the intuitions of past political philosophers were correct.

Empirical evidence shows correlation between homeownership and personal and social benefits.[144] Homeownership is correlated to higher levels of self-esteem,[145] and leads to stronger ties in the community, helping build the base for political and social cohesion.[146] This increase in feelings of positive self-worth, compounded with a greater stake in one's community leads to a positive self-reinforcing cycle as homeowners are committed to protecting home and community values.[147] Areas with higher

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[143] *Id.* at 422-23.

[144] William M. Rohe, Shannon Van Zandt, & George McCarthy, *The Social Benefits and Costs of Homeownership: A Critical Assessment of the Research* 3 (Joint Center for Housing Studies of Harvard University, Working Paper LIHO-01.12, 2001) *available at* http://www.jchs.harvard.edu/sites/jchs.harvard.edu/files/liho01-12.pdf [https://perma.cc/LA3H-D5W8] ("Strong and consistent evidence indicates that homeowners are more likely to: a) be satisfied with their homes and neighborhoods; b) participate in voluntary and political activities; and c) stay in their homes longer, contributing to neighborhood stability."); NAT'L ASS'N OF REALTORS, *supra* note 13, at 2.

[145] William M. Rohe & Michael A. Stegman, *The Effects of Homeownership on Self Esteem, Perceived Control, and Life Satisfaction of Low Income People*, 60 J. OF THE AM. PLAN. ASS'N 173, 173-84 (1994).

[146] Dickerson, *supra* note 20, at 191-92 ("Home ownership is also thought to benefit the individual homeowner's community since homeowners tend to be concerned, involved citizens who are more likely to participate in local civic organizations, who will lobby for long-term or high quality community services (like building new highways and neighborhood schools), and who will help ensure neighborhoods remain safe."); NAT'L ASS'N OF REALTORS, *supra* note 13, at 10-11.

[147] Rohe, Van Zandt, & McCarthy, *supra* note 144, at 12 ("Collectively, homeownership is thought to confer benefits to the neighborhood by stabilizing property values, encouraging maintenance and upkeep of properties and improving social conditions like high school dropout rates or crime rates (Rohe and Stewart 1996). Economically, the individual may benefit from neighborhood stability through stable or increasing property values. Further, individuals are thought to benefit socially by becoming more invested in their communities. Rohe and Stewart suggest that, beyond homeownership, 'living in a relatively stable neighborhood will further encourage participation in community organizations, local social interaction

percentages of homeownership, for example, experience lower crime rates.[148] This is also true in the reverse, areas with low homeownership have more social problems.[149] Increased homeownership also increases neighborhood and community value, leading to beneficial effects for the community as a whole.

Further positive externalities include psychological benefits for children and better performance in school.[150] There have been "consistent findings [that] show that homeownership does make a significant positive impact on educational achievement."[151] This is in part due to the fact that "being a homeowner may limit the severity of economic hardship and the degree to which financial hardships result in . . . stress and disengaged parenting."[152] When stressors are reduced, it increases the level of engagement with children.[153] Homeownership thereby has a strong positive impact on the lives of parents and children, justifying government involvement in promotion of homeownership, especially for low- to moderate-income earners.

Homeownership also leads to better physical health.[154] Homeownership means less stress, including less stress when major life changes occur.[155] Homeowners also "report higher self ratings

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and attachment, property maintenance, neighborhood satisfaction, and positive expectations about the future of the neighborhood'"); NAT'L ASS'N OF REALTORS, *supra* note 13, at 10, 14.

[148] Edward L. Glaeser & Bruce Sacerdote, *Why is There More Crime in Cities?*, 107 J. OF POL. ECON. 225, 225-58 (1999).

[149] Rohe, Van Zandt, & McCarthy, *supra* note 144, at 14; NAT'L ASS'N OF REALTORS, *supra* note 13, at 14.

[150] Dickerson, *supra* note 20, at 191.

[151] NAT'L ASS'N OF REALTORS, *supra* note 13, at 7.

[152] *Id.* at 9-10.

[153] *Id.* at 10.

[154] Rohe, Van Zandt, & McCarthy, *supra* note 144, at 10 ("The weight of the limited evidence on the relationship between homeownership and health suggests that there is a positive association between homeownership and health, as long as the household is current on its mortgage payments."); NAT'L ASS'N OF REALTORS, *supra* note 13, at 12-13 ("Nonetheless, there are a few academic studies that provide evidence of the positive impact of homeownership on health even after controlling for factors like income and education.").

[155] Rohe, Van Zandt, & McCarthy, *supra* note 144, at 5, 10 ("The results of a multivariate analysis indicate that, after controlling for income and education, home-owning workers reported significantly less economic strain, depression, and problematic alcohol use than did renters. These

on their physical health even after controlling for age and socioeconomic factors."[156] Finally, physical health has been linked to financial well-being, which may depend on factors such as "home ownership, the number of children [in a family], health insurance, age, and income."[157] Of course homeownership does not directly increase physical and financial well-being, but the security of being in a home, and the benefits of making payments towards ownership rather than renting, should not be discounted.

Empirical research clearly shows correlative factors between homeownership and a wealth of physical and social benefits.[158] There are also more subtle benefits to homeownership, in a nation that values freedom and individualism above much else, "[o]wning a home embodies the promise of individual autonomy."[159] As a nation that has the wealth and ability to institute social programs that go beyond the mere protection of its people, the U.S. government is justified in instituting policies that support homeownership.

B. Homeownership and Stability

Although there is evidence linking homeownership and social benefits,[160] there is also evidence that homeownership can have detrimental effects for low- to moderate-income earners when stability is decreased due to foreclosure or economic uncertainty.[161] Financial stability is the foundation that underlies the beneficial elements of homeownership.[162] When financial stability is threatened, it can lead to homeownership having adverse effects

findings suggest that the economic and/or psychological stability engendered by homeownership may dampen stress related to job loss . . . .").

[156] NAT'L ASS'N OF REALTORS, *supra* note 13, at 13.

[157] *Id.*

[158] *See* discussion *infra* Part IV.A.

[159] NAT'L ASS'N OF REALTORS, *supra* note 13, at 16.

[160] *See* discussion *infra* Part IV.A.

[161] Rohe, Van Zandt, & McCarthy, *supra* note 144, at 3 ("These arguments, however, assume that the homeownership experience is a positive one. If the homeowner is faced with major unexpected problems with the home or the surrounding neighborhood, or the value of the home depreciates, homeownership might be expected to decrease satisfaction.").

[162] NAT'L ASS'N OF REALTORS, *supra* note 13, at 7.

instead of beneficial ones.[163] Affordable housing policy-makers must consider the larger effects of their policies when giving low- to moderate-income earners the ability to purchase a home undermines their overall financial stability.

This concept of stability is consistent with the framers' conception of property ownership as well. Scholars suggest that Jefferson believed that it was "impossible to corrupt an entire nation so long as the majority of its citizens are small landowners, dispersed across the landscape, dependent on no one but themselves for their livelihood."[164] With the movement of many Americans to more urban settings, the founders' ideas of land ownership resulting in subsistence farming is clearly less relevant today, but the idea of economic independence certainly is still important in modernity. That is, while "[t]he idea of land ownership has been subsumed as an end itself . . . land ownership is necessary only insofar as it is a means of accomplishing the ultimate end of economic independence, and from economic independence comes real liberty."[165] Again, when we look to statistical data that modern sociological and psychological experimentation, it supports the inference that it is not homeownership itself that is important, but economic stability as a whole.

Beneficial effects of homeownership disappear when financial instability leads to threats of foreclosure.[166] First, the threat of foreclosure leads to feelings of less self-control, which may lead to decreased self-esteem.[167] Second, foreclosure leads to long-term detrimental effects such as difficulty borrowing in the future.[168]

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[163] Rohe, Van Zandt, & McCarthy, *supra* note 144, at 6 ("Financial instability puts lower-income households at risk of losing their homes due to mortgage foreclosure. The psychological impact of homeownership could be negative if a person is unable to pay their mortgage and is forced from his or her home. It may also be negative if the house is found to have major problems or if owners do not have sufficient incomes to maintain their homes.").

[164] Korff, *supra* note 140, at 426-27 (internal quotations omitted).

[165] *Id.* at 427.

[166] Dickerson, *supra* note 20, at 211-212; Rohe, Van Zandt, & McCarthy, *supra* note 144, at 6, 10.

[167] Rohe, Van Zandt, & McCarthy, *supra* note 144, at 6, 8.

[168] Dickerson, *supra* note 20, at 209 ("Losing an investment in a home can have a long-term detrimental effect on the homeowner and may make it prohibitively expensive for them to purchase a home in the future. Data show that homeowners who lose their homes—for any reason—may be

Further, when low- to moderate-income earners put all of their money into a home, they are unable to invest in other places.[169] Consequently, homeowners may be left unable to afford higher education for their children, negatively influencing their educational experience.[170]

Additionally, when economic instability leads to drops in home values, leading to the inability to refinance and foreclosure, homeownership may decrease mobility for individuals living in distressed neighborhoods, thereby compounding social problems.[171] The quality of one's neighborhood is important psychologically, as happiness has been linked to neighborhood characteristics.[172] Further, when neighborhood values drop as foreclosures increase, devaluation can result in concentrations of poverty and rising costs on municipalities in the form of increased crime and reduced tax revenues.[173] The effects ripple out, as evictions for renters increase

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unable to re-enter the home buying market for a decade because of the effect the foreclosures have on the borrowers' credit rating and also because of the time it takes for the homeowners to generate additional savings to replenish the money they lost in the investment in their homes.").

[169] *Id.* at 210.

[170] *Id.*

[171] Rohe, Van Zandt, & McCarthy, *supra* note 144, at 13.

[172] *Id.* at 4.

[173] Dickerson, *supra* note 20, at 211-212 ("Foreclosed properties also reduce the value of nearby homes because appraisers include foreclosure sales as comparable neighborhood sales when determining the value of all homes, even though foreclosed properties often are sold for only a fraction of their original loan value. The stigma and economic effects (and also the appearance) of foreclosed properties in close proximity thus harms owners of neighboring properties who are trying to sell their homes, refinance higher rate loans, or obtain new financing even though they have acted responsibly and borrowed wisely and they do not have risky subprime loans. This, in turn, can create a cycle of negative disinvestment. Rising mortgage foreclosures also harm municipalities.") ("Cities are often forced to increase police protection in areas with vacant homes to protect the homes from vandalism, to prevent criminal activities from taking place in the homes, or to investigate suspected arson committed by homeowners who cannot afford their mortgage payments. A downturn in the real estate market also harms cities because it decreases municipal revenue (for example, the issuance of fewer building permits), results in lower property tax revenues from vacant houses, lowers revenue generated by property assessments, and imposes additional costs associated with maintaining the appearance of vacant properties"); Rohe, Van Zandt, & McCarthy, *supra* note 144, at 13 ("In

when landlords can no longer pay their mortgages.[174] Entire communities may thereby be destabilized by high rates of foreclosure that spread burdens across individuals, including homeowners, landlords, and tenants, as well as burdens on municipalities in general.

Finally, physical health may deteriorate due to extreme stressors in an individual's environment, such as foreclosure and eviction.[175] Self-efficacy, or increased perceptions of self-control, has been linked to increased physical health, thus when stress surrounding impending foreclosure lessens one's feelings of self-control, it can have negative physical effects.[176] Difficulty making mortgage payments itself has been linked to an increase in how often homeowners visit their doctor.[177] Given the potential for detrimental physical and psychological effects, it is clear that homeownership is not actually beneficial when it is accompanied by financial and economic instability.

Not only does the threat of foreclosure impose obvious psychological detriments on homeowners, but it can lead to a loss of opportunity, financially and for future generations, as well as decreased physical health. It is vital, then, that U.S. government affordable housing polices ensure that while promoting affordable homeownership, they are not negatively impacting the long-term stability of the very homeowners they are trying to help, as has occurred in the recent financial crisis. Given the net loss of homeownership after financial crisis, [178] government policies

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recent years, indices of both dissimilarity and isolation have increased, meaning that more poor households are living in areas of concentrated poverty, with less access to people different than themselves (Abramson et al. 1995). Segregation and isolation stunt the ability of neighborhood residents to improve neighborhood social characteristics, such as levels of employment and the number of families on public assistance, as well as physical characteristics like the number of dilapidated houses or the median value of homes.").

[174] Dickerson, *supra* note 20, at 213.

[175] Rohe, Van Zandt, & McCarthy, *supra* note 144, at 5-6, 10 ("Results indicate that having difficulty making mortgage payments was associated with lower scores on a general well-being scale among both men and women and it increased the likelihood of men visiting their general practitioners.").

[176] *Id.* at 5-6.

[177] *Id.* at 10.

[178] *Id.* at 209.

supporting affordable homeownership in recent decades may have actually harmed low- to moderate-income earner homeownership more than they helped.

V. The Future of the GSEs

If United States government policies supporting homeownership do not actually help low- to moderate-income earners when for-profit enterprises implement those policies, the GSEs have failed and the U.S. government needs to consider an alternative to implement their housing policies. Certainly, while the GSEs were successful in reviving a stagnant economy after the Great Depression,[179] developments around the turn of the century brought to light the fact that the GSEs had a "deeply flawed business model as publicly traded corporations with the implicit backing of . . . the federal government and with a public mission."[180] The dangerous investment strategies of the GSEs, although practiced by other entities, became especially dangerous due to the tension between the goals of a profit-seeking enterprise, the limits placed on such an enterprise by a government-backed charter, and the implicit government backing of the enterprise.[181] Whether one believes that the GSEs were under-regulated, a victim of private market voracity, or over-regulated, it is clear that the nature of the relationship between affordable housing goals set by the U.S. government, the GSEs, and their competition with the private sector led to an increase in systemic risk and moral hazard.[182]

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[179] *See* discussion *infra* Part II.A.

[180] FIN. CRISIS INQUIRY COMM'N, *supra* note 7, at xxvi.

[181] Abrams, *supra* note 30, at 174 ("Most financial entities could have diversified their proceeds from the sales of MBSs by investing in something unrelated to housing. Fannie and Freddie did not have the ability to diversify, however. This was expressly forbidden by their charters. This limited their ability to mitigate their exposure and forced them to operate with highly correlated assets involving similar features and risks. . . . With the government guarantee, hedging for risk would not affect the debt holders, as taxpayers would ultimately be held responsible for any shortfall. Fannie and Freddie perpetuated the perception of this guarantee to retain the competitive benefits the implied guarantee provides.").

[182] *Id.* at 175, 177.

The GSEs are currently under conservatorship;[183] however, "[l]ong-term, continued operation in a government-run conservatorship is not sustainable for Fannie Mae and Freddie Mac because each company lacks capital, cannot rebuild its capital base, and is operating on a remaining, finite line of capital from taxpayers."[184] There are several possible ways to move forward with respect to the GSEs. First, they could continue to operate as quasi-public entities, second, they could be turned into entirely private companies, or third, they could become exclusively public entities under the control of the U.S. government.

The first option—continued operation with a modified regulatory structure—seems to be the path down which the GSEs and the legislature are heading. The Dodd-Frank Act, for example, addresses the future of GSEs to some extent by requiring investigation into future possibilities for the GSEs,[185] hopes to improve regulation of the companies by creating the Financial Stability Oversight Counsel (FSOC),[186] and gives the body the ability to set prudential standards for the GSEs.[187] If one subscribes to the theory that the failure of the GSEs was solely due to lack of sufficient regulation, than this could be a viable solution. Indeed, scholars have pointed to OFHEO's failure as a regulator,[188] a problem that could theoretically be addressed if FSOC is a more capable administrative entity. Similarly, capital and prudential standards for GSEs could curtail the amount and quality of investments that GSEs engage in, thereby exposing them to less risk and controlling their leverage ratios. Finally, it is possible that legislators will learn from past mistakes and be careful in drafting legislation that impacts the housing market to ensure that subprime lending is carefully regulated. If legislators are able to learn from past mistakes *and* if one believes that under-regulation was the sole cause of the failure of the GSEs, then tweaking the regulatory

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183 Fed. Hous. Fin. Agency, *History of Fannie Mae & Freddie Mac Conservatorships*, FED. HOUSING FIN. AGENCY, http://www.fhfa.gov/Conservatorship/Pages/History-of-Fannie-Mae--Freddie-Conservatorships.aspx (last visited Apr. 22, 2014, 2:16 PM).
184 *Id.*
185 Abrams, *supra* note 30, at 180.
186 *Id.* at 181.
187 *Id.*
188 *See* discussion *infra* Part III.A (discussing regulatory failure as a contributing factor to the failure of the GSEs).

structure of the GSEs, but leaving them essentially as they are, is a viable solution.

If one does not believe that regulatory failure was solely responsible for the failure of the GSEs, however, then maintaining the GSEs looks less like an intelligent and viable option. Such a solution does not address the fact that the same mistakes could be made years in the future when the financial crisis has faded into memory. Although the Dodd-Frank Act contains a provision stating that companies will no longer be bailed out by the federal government,[189] there is no guarantee that the entities and the legislature will not amend this legislation in the future. Much as the government and the market became complacent as memories of the Great Depression faded from view, history could repeat itself a century from now if regulators do not recognize the inherent tension between profit motives and affordable housing goals. A government guarantee, whether explicit or implicit, will assuredly tend to result in reliance on that guarantee, especially as markets recover and new generations of investors are inevitably less risk-averse than their predecessors. And when affordable housing goals are sought to be implemented by a for-profit entity with such an implicit backing, the motivation for profit combined with a public safety net increases the opportunity for significant moral hazard. The solution of re-vamping the existing regulatory system and leaving the GSEs as they are, quasi-public, quasi-private entities, is not a solution, but a continuation of the same old problem.

As a second option, privatization could work if one believes that the main cause of the failure of the GSEs was too much regulation. Those who advocate this theory maintain that the GSEs, as entities that were motivated by profit, had incentives to exploit the benefits of their implicit government backing and special charters.[190] If the GSEs were privatized, regulations functionally requiring GSEs to invest NTMs in order to promote affordable housing goals would be a non-issue. These new non-GSEs would be free to operate in the free market the way that any other private entity does. The fact that the United States government would lose a tool to promote its affordable housing goals is addressed by the argument that the government has other ways to implement housing policy, through the FHA, HUD, subsidies, and the tax code.[191] Some "argue that federal

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[189] *Id.*

[190] *See* discussion *infra* Part III.C.

[191] CONG. BUDGET OFFICE, PUB. NO. 4021, *supra* note 2, at 18-19.

agencies do not have expertise in certain areas of the market where the GSEs play and important role . . . and that a federal agency would probably be less flexible and less able to serve borrowers' evolving needs."[192] Similarly, complete privatization of the GSEs would impact the ability of the government to implement affordable housing goals, but only to a certain extent, as other programs exist. However, it might be worth losing this flexibility in order to reduce the risks posed by the GSEs.

Privatization could be a viable solution in the sense that it might insulate taxpayers from some of the risks posed by the GSEs, but not only would the government would lose a valuable tool in implementing affordable housing policy, but privatized entities may be just as likely to fail—and to be bailed out by the government. Such a solution does not solve the problem of having a government agent as a player in the secondary mortgage market, but it attempts to remove the problem entirely by taking government goals out of the picture. Nor does such a solution address the issue of systemic risk, because private market actors were engaging in systemically risky behavior in the period leading up to the financial crisis notwithstanding the GSEs, and also failed.

Nationalization of GSEs, on the other hand, addresses each of these concerns. Making the GSEs federally operated entities would first, eliminate any problem of under-regulation and eliminate the inherent tension between two competing primary goals: profit-seeking and implementation of affordable housing goals. The elimination of the profit-seeking motivation would also address concerns about GSEs taking cues from private market actors and engaging in risky investments. Further, in such a model the implicit guarantee of the government would be replaced by an explicit one, and the operations of the entities would be figured into the national budget.[193] Nationalization could also have a stabilizing effect on the private market for MBSs because "such a program would be more likely to ensure a fairly steady flow of funds to the secondary mortgage market—both in normal times and during periods of financial stress . . . ."[194]

The main proponent of the nationalization approach has been former Treasury Secretary Henry Paulson, himself a fiscal

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[192] CONG. BUDGET OFFICE, PUB. NO. 4021, *supra* note 2, at 35.
[193] CONG. BUDGET OFFICE, PUB. NO. 4021, *supra* note 2, at xvi.
[194] *Id.*

conservative.[195] Paulson recognizes "the inherent conflict in this structure . . . the GSEs served both a public mission and private shareholders—they received public support but operated for private shareholder gain."[196] Under Paulson's model, the GSEs would become part of the FHA and be regulated like public utilities.[197] This is in effect what has been going on for the past several years while the GSEs have been in conservatorship. Infused with federal bailout money, the GSEs have served the same role in this financial crisis as they did in the aftermath of the Great Depression, keeping the U.S. housing market afloat.[198] Although ostensibly once the market is stabilized there would be less of a need for government intervention in the secondary mortgage market, it seems wasteful to not use companies with a highly developed infrastructure and expertise to not support affordable housing policy goals. Of the three potential options for dealing with the GSEs, nationalization supports policy considerations while reducing systemic risk by removing the pressure of profit from the equation.

On the other hand, are the GSEs necessary anymore? Perhaps pushing the GSEs into the policy arena was a mistake to begin with. Perhaps the government should have left policy implementation to the FHA and HUD, instead of working to dramatically increase the number of homeowners by implementing housing policy through the GSEs. Further, given the hypothesis that it is not homeownership itself that is beneficial to Americans, but economic independence and stability that may come from homeownership, perhaps the United States government would be better served by attempting to assist people in achieving economic independence through other channels, and focus less on affordable housing. Economic independence, for example, can be attained through education about responsible financial activities, job growth, job stability, and rent stability. In an age where land ownership is less attainable for many individuals, perhaps a focus on rental markets would better serve the American people.

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[195] Reiss, *supra* note 19, at 949.

[196] Henry M. Paulson, Jr., Secretary of the Treasury, On the Role of the GSEs in Supporting Housing Recovery 3 (Jan. 7, 2009) *available at* http://www.economicclub.org/doc_repo/paulson_transcript%20JF%20Revision.pdf [https://perma.cc/7UVG-8S72].

[197] Reiss, *supra* note 19, at 949, 952.

[198] *Id.* at 950.

VI. Conclusion

If the U.S. government is going to implicitly or explicitly guarantee securities with tax-payer dollars, the government needs to shield this guarantee from becoming too connected to the private sector, even if it means that entities such as the GSEs are running as a less-than-profitable business. So, the United States government needs to make a decision. Are the GSEs, as they exist now, important enough and well-developed enough tools for the implementation of affordable housing goals? Can their functions and the roles that they fill be displaced onto other government agencies that do not operate under the quasi-public quasi-private model? Or have these entities become so vital to the operation of our secondary mortgage market that they should not be privatized lightly?

Setting goals for affordable housing in America is a worthy aim but cannot be accomplished through profit-seeking entities that have a much different underlying goal: to make profit, not to ensure that those with fewer financial resources have a chance to succeed. Homeownership does have positive effects on families and individuals, but if the government is going to promote homeownership as a goal they need to do it in a way that is less risky than the current model, because the benefits of homeownership disappear when individuals are faced with foreclosure or the generally detrimental effects of the financial crisis. If the government can implement its affordable housing goals through other means, such as the FHA and HUD, then privatization of the GSEs seems to be a good option. If the role the GSEs play is vital to the implementation of policy goals, then they should be nationalized. One thing that is clear, however, is that the model of the GSEs has to change due to systemic dysfunction with the for-profit, quasi-public agency model.