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TAXPAYER EXPOSURE IN THE HOUSING MARKETS

THURSDAY, JUNE 2, 2011

House of Representatives

Committee on the Budget

Washington D.C.

The Committee met, pursuant to call, at 10:30 a.m., in Room 210, Cannon House Office Building, Hon. Paul Ryan, [Chairman of the Committee] presiding.

Present: Representatives Ryan, Garrett, Campbell, Black, Mulvaney, Young, Rokita, Van Hollen, Kaptur, Doggett, McCollum, Pascrell, Honda, Wasserman Schultz, Castor.

Chairman Ryan. Welcome all to this very important hearing. The purpose of today's hearing is to highlight the true cost and risk posed by the government's ongoing bailout of Fannie Mae and Freddie Mac. It also seeks to shed some light on the hidden cost of the mortgage insurance program run by Federal Housing Administration. This is obviously a very complex subject, but a critically important issue. The federal take-over of Fannie and Freddie is the most costly taxpayer bill out in the wake of the 2008 financial crisis.

For years, we were told Fannie and Freddie posed no liability to federal government. Through their unique status cultivated through political influence, they pursued, what I would call "crony capitalism." And the taxpayer is now being stuck with the bill. To date, the Treasury Department has provided about a $160 billion to Fannie and Freddie, and the CBO estimates that they are all end-cost for the decade will be about $370 billion. While the Treasury Department has put forward a framework for reform, the Obama Administration still does not account for these estimated future cost its budget, even though it has lifted the cap on Fannie and Freddie's line of credit. When it comes to this ongoing bail out of Fannie and Freddie, taxpayers have a right to know how much they are on the hook for. FHA is different than these two GSEs because it is included in federal budget totals. However, the current budgetary treatment of FHA under states the risks and costs of FHA guarantees, which now amount to nearly a fifth of all new single-family home loans. While CBO adjusts the cost of Fannie and Freddie loans for market risk under Federal Credit Reform Act, budget projections do not incorporate market risk into the cost of FHA guarantees. The housing market is still in a very fragile shape; all the recent news confirms this. There are no two ways about it.

For the homeowners, for taxpayers and for working families across this country, we need to put an end to an ongoing bailout of Fannie and Freddie and advanced serious permanent solutions. That starts with a full accounting of their activities. We must advance plans to reform Fannie and Freddie to fully account for FHA loans and to stop the hemorrhage of taxpayer dollars and to limit the government's dominance and distortion of housing finance.

I look forward to hearing from our witnesses today regarding these serious problems, and I look forward to a constructive debate on how we can save taxpayers from the consequences of misguided housing policy and crony capitalism, now and in the future.

We have our own experts from our side of the aisle, Mr. Garrett and Mr. Campbell, what are senior members of the Banking and Financial Services Committee. But before I turn it over to the witnesses, I would like to recognize, Mr. Van Hollen for his opening statement.

[The prepared statement of Chairman Paul Ryan follows:]

********** COMMITTEE INSERT **********

Mr. Van Hollen. Well, thank you, Mr. Chairman. And let me also join you in welcoming our witnesses today. As the chairman said, this hearing focuses on a number of issues, including the technical issue of how to best account for the cost of federal support for the housing markets, both now and possibly into the future. That has a very important question. Whatever method we use should accurately and transparently provide the best estimate of what those costs are to the taxpayer.

But the larger question, and the one that will have a much bigger impact on taxpayers and the economy are what housing policies decisions we make going forward, and how they will first influence the ultimate cost to taxpayers and homeowners of the book of business originated before the housing crisis and the financial melt-down; and two, whether our housing policies decision going forward will ensure that creditworthy borrowers will still have access to credit and be able to achieve the American Dream of homeownership.

I do not know anyone who has proposed that we return to a system of what amounted to first an implicit and then an explicit government guarantee. The Treasury Department's February white paper on housing reform calls for reducing overall government support for the housing market and winding down Fannie Mae and Freddie Mac. The key question is what would a reformed housing market look like and what role, if any, should federal government have in that. As the chairman mentioned, and we all know, the housing market is in a very fragile state right now.

One proposal that is been advanced by Congressman Hensarling and six members of this committee, would very quickly end any federal role in the housing market. I am very concerned that those proposals, which would create fire sales of GSE portfolios, would only further depress home values and reduce the return to taxpayers of the current portfolio at Fannie Mae, regardless of what cost accounting method we use. Those concerns are shared by many others. And Mr. Chairman, I ask unanimous consents just to put in the records, statements from the home builders and the realtors, people who are, of course, intimately involved in the housing market.

Chairman Ryan. Without objection.

[The information follows:]

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Mr. Van Hollen. And there is also a bipartisan concern on that score. As you mentioned, there has been other legislation introduced that does not immediately wipe out any federal participation, but, in fact, allows federal participation to go forward in a much more responsible way. That has been introduced by Congressman Campbell, Gary Peters, and others that preserve a limited government role and one that is designed to protect the taxpayers but also allow for creditworthy borrowers to have access to the market.

Others, like the Center for American Progress that put forward their own proposals and I commend them for putting something on the table. So Mr. Chairman, I thank you for holding this hearing. I think the question of how we account for these costs is, of course, an important one and I look forward to the testimony. But the real cost and the larger cost in the long run to taxpayers, homeowners and the economy will be determined by the housing policy decisions that we make here in the Congress. So with that, I thank you, and again, thank you for the witnesses.

[The prepared statement of Chris Van Hollen follows:]

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Chairman Ryan. Thank you. Today we are joined by Dr. Deborah Lucas.

Mr. Campbell. Mr. Chairman?

Chairman Ryan. Yeah.

Mr. Campbell. Before we get to the witnesses, I would ask unanimous consent to submit for the record a letter from the National Association of Realtors.

Chairman Ryan. Sure, and without objection.

Mr. Campbell. Thank you.

[The information follows:]

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Chairman Ryan. Anybody else want to submit anything? Sure, we will have the clerk make photocopies and distribute it out.

Mr. Garrett. As long as you do it, I was going to do it at the end, but since you are doing it. One for the National Multi Housing Council letter.

Chairman Ryan. Okay, without objection.

[The information follows:]

********** COMMITTEE INSERT **********

Chairman Ryan. Anybody else want to submit something for the record? We will send copies of this one around as well.

We are joined today by Deborah Lucas, the assistant director of the financial analysis division from the CBO. Also Alex Pollock, who is no stranger to this committee, a resident fellow at the American Enterprise Institute, former chair of the Chicago Federal Home Loan Bank, if I am not mistaken, and Sarah Rosen Wartell, executive vice president from the Center For American Progress Action Fund. Why do not we just start with Deborah and then move over?

STATEMENTS OF DEBORAH J. LUCAS, ASSISTANT DIRECTOR, CONGRESSIONAL BUDGET OFFICE; ALEX J. POLLOCK, SENIOR FELLOW, AMERICAN ENTERPRISE INSTITUTE FOR PUBLIC POLICY RESEARCH; AND SARAH ROSEN WARTELL, EXECUTIVE VICE PRESIDENT, CENTER FOR AMERICAN PROGRESS & CENTER FOR AMERICAN ACTION FUND

STATEMENT OF DEBORAH J. LUCAS

Ms. Lucas. Okay. Thank you. I appreciate the opportunity to testify about CBO's estimates of the budgetary cost of Fannie Mae and Freddie Mac, and the options for the future role of the federal government in the secondary mortgage market.

In CBO's judgment, federal conservatorship of Fannie Mae and Freddie Mac and their resulting ownership and control by the Treasury, make them effectively part of the government and imply that their operations should be reflected in the federal budget. Hence, in its baseline budget projections, CBO accounts for the cost of the GSE's operations as though they are being conducted by a federal agency.

Now after consulting with the House and Senate Budget Committees, CBO concluded that using a so-called fair value approach to estimate those costs would give the Congress the most accurate and comprehensive information about the budgetary cost of supporting the GSEs. A fair value approach provides estimates of the value of the GSE's assets and liabilities that either corresponds to or approximates prices in a well-functioning financial market.

Using that method, back in August of 2009, CBO estimated that the net cost to the government of all of the GSE's outstanding mortgage commitments made through the end of 2009 would total $291 billion. Now, since that time, CBO has not updated its cost of the government of those past commitments. However, the GSE's financial report suggests that losses on those obligations may have increased somewhat since that time because of the continued weakening of the housing markets.

So, looking forward, in its recent March 2011 baseline projections, CBO estimates that the new guarantees the GSEs will make over the next decade will cost the government $42 billion.

The subsidy rate for the GSE's new business has fallen since the peak of the financial crisis and it is projected to decline further as conditions in the housing market and the economy improve. However, under a fair value approach, the subsidy rate will remain positive as long as Fannie Mae and Freddie Mac provide guarantees at prices below what private financial institutions would offer.

Now, unlike CBO, the Administration's Office of

Management and Budget treats Fannie Mae and Freddie Mac as non-governmental entities for budgetary purposes. That implies that in the budget, OMB records only cash transfers between Treasury and the GSEs, such as for stock purchases and dividend payments. That approach can postpone the recognition of the costs of the GSE's new guarantee obligations for many years.

The fair value approach that CBO is using for projections is also different than the procedures specified by Federal Credit Reform Act of 1990, otherwise known as "Credit Reform," which applies to most federal credit programs. Unlike Credit Reform estimates, which use Treasury rates for discounting, fair value estimates use discount rates that incorporate a risk premium. The inclusion of a risk premium recognizes that the financial risk to the government that it assumes when it issues mortgage guarantees, represents a cost to taxpayers.

Now, those two approaches paint very different pictures of the cost of continuing to operate Fannie Mae and Freddie Mac under a current law over the next decade, whereas, on a fair value basis, their new obligations generate rate a budgetary cost under Credit Reform, the continuing operations would result in budgetary savings.

Currently fair value accounting is used for the troubled asset relief program and by CBO for the GSEs, but the Credit

Reform approach is used for most federal mortgage guarantee programs, including the Federal Housing Administration's Single Family Mortgage Insurance Program.

CBO recently estimated the difference between the two methodologies as applied to that FHA program. Under Credit Reform, the FHA program would produce budgetary savings of $4.4 billion in fiscal year 2012, but on a fair value basis, the program would cost $3.5 billion in the same year. That different budgetary treatment of the GSEs and the FHA means that a mortgage that generates a budgetary cost when it is guaranteed by Fannie Mae or Freddie Mac could show budgetary savings if FHA provide the coverage instead.

Policymakers are contemplating a wide range of proposals for federal role in the secondary mortgage market, in general, for the future of Fannie Mae and Freddie Mac, in particular, and for the transition path to a new model. In a recent study, CBO analyzed those alternatives and the trade-offs among them. And my written statement summarizes that work. Any new approach would need to confront major design issue; if the approach includes federal guarantees, how to structure and price them, whether to support affordable housing, and if so, by what means, and how to structure and regulate the secondary market.

Options will need to be evaluated using several criteria, including whether a given alternative would ensure a stable supply of financing for mortgages, how affordable housing goals would be met, how well taxpayers will be protected from risk, whether the federal guarantees would be priced fairly, and to what extent the approach would provide incentives to control risk-taking.

Whichever direction is ultimately chosen, the policy choices will have budgetary implications that could differ considerably depending on the budgetary treatment used. In CBO's judgment, continuing a fair value approach to estimate subsidy costs for Fannie Mae and Freddie Mac would provide the most accurate measure of the cost to taxpayers of any eventual transition to a new federal role in the secondary mortgage market. However, doing so would maintain the practice of accounting for similar federal credit programs and financial transactions in different ways. Thank you.

[The prepared statement of Deborah Lucas follows:]

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Chairman Ryan. Mr. Pollock?

STATEMENT OF ALEX J. POLLOCK

Mr. Pollock. Thank you, Mr. Chairman, Ranking Member Van Hollen, and members of the committee. Over the past four decades in this country, we have engaged in a truly remarkable financial experiment, or adventure of exploding agency debt, which is described in the graphs and the discussion in my written testimony. Now, this explosion in my view, calls into question old ways of thinking about accounting for, and managing, such debt. A vast debt of the non-budget agencies and government-sponsored enterprises, most of which is devoted to subsidizing housing finance, fully relies on the credit of the United States. This means by definition, it exposes taxpayers to losses, but, as we know, it is not officially accounted for as government debt. This debt puts federal budget at risk, or more precisely, subjects it to major uncertainties and potentially huge credit losses, as we have experienced. Indeed, it represents a kind of off-balance sheet financing and risk-taking by the government. Fannie Mae and Freddie Mac in particular, can quite reasonably be thought of as government SIVs or S-I-Vs, and the analogy to say the SIVs used by Citibank to try to finance mortgages off off-balance sheet, is quite a tight analogy.

In 1970, some 40 years or so ago, Treasury debt held by the public as $290 billion. Seems like a small number these days. And agency debt was $44 billion; so $290 versus $44.

By 2006, at the height of the housing bubble Treasury debt was almost $5 trillion, but agency debt had inflated to $6.5 trillion dollars. So over this time while Treasury increased 17 times, agency debt had multiplied 148 times. This created a, altogether, new and unprecedented situation in government finance.

In 1970, agency debt represented only 15 percent of outstanding Treasury debt. By 2006, this had inflated to 133 percent of Treasury debt. So, if you were managing the Treasury debt, you were managing less than half of the government's credit exposure. If we add these two types of debt together, we get what I call "effective government debt", that is debt dependent on the government's credit, which is held by the public, and this number is now nearly $17 trillion as shown in my written testimony.

How was this agency debt explosion possible, we should ask. The financial reality is that bond salesmen peddling trillions of dollars of Fannie, Freddie, and other agency securities to investors all over the world, said to them something very much like this: "You cannot go wrong buying these because they are really U.S. government credit. But they pay you a higher yield so you get more profit with no credit risk." And although this description was disputed by various official voices, in fact, what the bonds salesmen said was absolutely right, as experience has demonstrated, it was a good deal for the bond-buyers but it was hardly a good deal for the taxpayers.

How can we better think about the risk to the taxpayers represented by the explosion of agency debt? For entities subject to Federal Credit Reform Act, the expected, or that is really the best guess estimates of losses, must be reflected as costs in federal budget. This requirement is useful, but it does not address the fact that we do not and cannot know what the losses will turn out to be. As the Congressional Budget Office points out, the FHA, for example, has often had to significantly increase its credit loss estimates which it worked so hard to make in the first place. The CBO correctly states, "The expected cost of defaults does not account for the uncertainly about how costly such defaults ultimately will be." I concur with the recommendation that the budget cost analysis should reflect the reality of this uncertainty, which is imposed on the taxpayers.

The explosion of agency debt means that managing the issuance of Treasury securities, as I said, has come to deal with only about half, and often less than half of the effective government debt. Now this brings me to two statutory recommendations.

Congressman Van Hollen asked about the government role. In my view, a key government role is to manage its own credit, all of its own credit exposure. And this means that the Treasury Department should be firmly in control of the government's credit and its use by the off-balance sheet agencies. So I propose that we return to the logic, we remember the logic of the Government Corporation Control Act of 1945, an act still in force. This act spells out the responsibility of the Treasury Department to control the debt expansion of government corporations with notable rigor, and I cite the language of the act in my written testimony. There is no doubt whatsoever that Fannie and Freddie are now mixed ownership government corporations. So I recommend that Congress should amend the Government Corporation Control Act, explicitly to add Fannie Mae and Freddie Mac to the list of mixed ownership government corporations in that act, thus formally subjecting them to the appropriate financial discipline of the Treasury.

A second useful reform was to find in the Revenue Act of 1992, passed by the Congress but not enacted due to a veto for other reasons, this provision would have forced the Treasury Department to focus on how agency debt affects the cost of treasuries required in annual report to the Congress on that question. And in my view, there is no question that the explosion of agency debt increases the cost of treasuries. It raises the interest rate on treasuries by creating a giant competing supply of government-backed debt to compete with treasuries. How big this increased cost is subject to some debate. A recent fed study suggests that by taking $1.7 trillion in government securities of which more than $1 trillion were agencies securities out of the market, the rate on the 10-year Treasury was reduced by 30 to 100 basis points. This is a Federal Reserve brand new study. We put this logic and just apply it in reverse, adding $7 trillion of agency debt to the market, certainly, or at least, plausibly would have increased the cost of financing the Treasury by a like amount. So, by increasing the cost of the Treasury, the agency debt actually increases the explicit government deficit by increasing the cost of financing the government.

So in this Revenue Act of 1992, the provision, which is quoted in my written testimony, would require an annual report of the Treasury analyzing the extent to which the behavior of agency debt has increased the cost of financing the Treasury itself. Now, I recommend that this provision should be reduced and enacted. In these ways, and I am sure there are others as well, we can help control for the future, the exposure of taxpayers created by the use of the government's credit card by agency debt. The consequent uncertainty of the true budget cost and the possibility of huge losses and the over-leveraging of the housing sector which uncontrolled agency debt promotes. Thank you very much for the opportunity to be here.

[The prepared statement of Alex Pollock follows:]

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Chairman Ryan. Thank you, Mr. Pollock. Ms. Wartell?

STATEMENT OF SARAH ROSEN WARTELL

Ms. Wartell. Good morning. And thank you, Chairman Ryan, Ranking Member Van Hollen and members of the committee. I am pleased to have the opportunity to testify today.

Today's purpose is to examine how the budget reflects the taxpayers' cost to federal support for the housing market through Fannie Mae, Freddie Mac and FHA, but before I speak to that issue I want to put in a broader context. Right now the GSE's in conservatorship and FHA are essential to stabilizing the housing market. Their new business is both prudently underwritten and most likely profitable, allowing them to make dividend payments to the Treasury, offsetting losses incurred on earlier obligations during the housing bubble, and so reducing the net cost to the taxpayer.

First quarter case Schiller Index shows that the housing market remains very weak. Had the GSEs and FHA not been able to pick up when the private market withdrew, the housing collapse would have far more severe and the recovery even slower; something we should remember as we think about the future. No one wants to sustain the current situation. Government bears the credit risk on over 95 percent of mortgages today. Going forward, private capital at risk must be made to bear at much of the load as is possible. But we must ensure that the private market is ready to pick up the slack before we withdraw federal support or we risk deepening the vicious cycle of falling home values and a shrinking economy.

The taxpayers' exposure to risk from the books of business originated before the housing collapse by the GSEs. It is fixed; there is nothing we can do about it; their exposure is fixed, but the ultimate cost of those obligations to the taxpayers is undetermined. The size of the losses that the taxpayers will pay will be determined in large part by the housing recovery, which in turn depends on the consistent availability of sustainable mortgage lending to the housing market. Limiting the GSE's role prematurely without a better design mechanism to ensure liquidity while protecting the taxpayers would weaken the housing recovery and have the effect of significantly increasing the GSEs and FHA's losses on past obligations, and thus the cost to the American taxpayer. With that in mind, let me address the budgetary treatment of the GSEs.

First, the cost to the taxpayers of government support for Fannie and Freddie is already reflected in the federal budget. There is an important technical debate between budget analyst about what is the best methodology to use to report these costs and that debate in part hinges on whether the GSEs are now governmental entities or more like a bank that has been taken over by the FDIC, which is not treated as a governmental entity, and also it hinges on what discount rates to use. Those are important discussions. But please, we should not suggest that they are not reflected in federal budget; the cost to the taxpayers of those obligations are.

The payments in revenues and the effect on the deficit can be found in fact on Table S12 on Page 201 of the president's Fiscal Year 2012 Budget. Where OMB projects for 10 years the payments made under the preferred stock purchase agreements to bolsters the GSE's capital position and the dividend payments to the Treasury that are required under those agreements to be made and returned. It also shows the balance of those two numbers, which is the programs net effect on the deficit. What is more, additional information regarding the financial position of the enterprises is reported in many places, including by the Treasury Department's audited financial statements, the enterprises 10-K filings with the SEC, and quarterly reports from FHSA, their conservator.

In my written testimony, I detail the consequences of the OMB and CBO approaches and my concerns with some of the inconsistencies created by the CBO approach, which is as Ms. Lucas noted in her testimony. I ask that that full statement be submitted for the record.

A second concern is that we must recognize why the budgetary treatment of the GSEs is so complex. We are talking about how to reflect in the budget today when we have an effective guarantee of the GSEs. Obligations that were occurred at an earlier time when the securities were not explicitly backed by the full faith and credit. This situation is unique and it is temporary. There will be a transition to a new system and the GSEs as we know them, will be unwound. There is no debate among the Administration, Congress or any party that that will be the case.

So what is far more important than a debate about the budget treatment of past obligations is to ensure that any future system of government support includes explicit terms, fees charged for any federal support provided, and reserves held on the books of the taxpayers to protect themselves against future losses. Any explicit guarantee in the future should be accounted for in the budget using standard treatment for credit liabilities under Federal Credit Reform Act, and which establishes consistent ground rules for ensuring that the true cost of credit obligations are recognized when incurred.

Personally, I support the availability of a government guarantee for liquidity targeted to support middle-class home buyers and renters. I am pleased to see that there is some emerging bipartisan support for this idea with Representative Campbell and Peters offering their own proposal which contains this core feature. But under any future plan, it is important that new guarantee obligations be treated under the same budget rules used for other federal credit programs, not that the entities are, but the guarantee costs are, so that the costs and benefits can be compared across programs under consistent assumptions.

Finally, let me close by commending the Chairman and the committee for this hearing. This is technical stuff, but it implicates issues that matter to every American family, as Congressman Van Hollen mentioned. What is at stake in the housing finance reform debate is what kind of future is available to all Americans middle-class families. Can creditworthy borrowers get non-discriminatory access to a 30-year fixed-rate mortgage? What that means for their family is that they can provide their families with the security of a home of their own on terns that they can afford. Will they see wild swings again in credit availability and the resulting depression of their home values and their savings? Will new quality rental housing be built to meet the burgeoning projected demand, or will instead see skyrocketing rents and limited choices for renters?

Congress and the administration have the responsibility to design a smart system of housing finance for the future that both protects the taxpayers and achieves these goals. I thank you, and would welcome a chance to answer any questions.

[The prepared statement of Sarah Wartell follows:]

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Mr. Garrett [Presiding]. I thank you for your testimony. I appreciate the panel's testimony. And at this time, I will yield myself such time, I guess, as I consume in this committee. Unlike financial services where I am limited to five minutes, I am told by Paul before he left, I can just go on ad nauseam here, but I will try not to do that.

Ms. Wartell, your comment at the end, you said, "This is technical stuff." But that is not any reason why we should not have transparency with what we are talking about. And I will start with Ms. Lucas on this point.

So we just had a hearing recently in Financial Services, and we brought up the letter up to Paul that CBO wrote with regard to this issue that the panels also addressed, and on the upside was the fact that there was agreement on everyone on the panel that, in fact, that there should be a reevaluation, if you will, of how the numbers are reported and to provide for more and greater transparency in regard to the budget and all. So that was the upside. The push-back, though, at least from one of the panelists was that well maybe the CBO just did not get it right. And looking back on the witness statement, it says, "The CBO maybe been a little off, and it used Fannie and Freddie fees and private mortgage fees as to determinate to how the market risks to FHA should be calculated."

Would you like just to spend a moment to expand upon your analysis and why that push-back is not correct but the CBO's analysis what for fair value is the correct analysis for determining on budget?

Ms. Lucas. Yes, Congressman. Thank you. I guess where I would like to start is to say that, of course, any estimate of these costs is extremely difficult to get right. I am not sure any of us would even know what right was when we saw it because it involves so many uncertainties. Remember that we are projecting the cash flows over the life of 30-year mortgages in a world where we do not know what is going to happen to housing prices, default rates, and so forth. So there is a great deal of uncertainty in these estimates whether they are done under Credit Reform or on a fair-value basis.

I think what is fundamentally important is that CBO is striving to give an unbiased estimate to the best of our ability. So when we are trying to go give these fair-value estimates, the idea is that you are trying to reflect what the price would be in a well-functioning financial market. Now, that was particularly challenging task for Fannie and Freddie, given how disrupted markets have been recently. But what we do is very much like the practice in private financial institutions that also have to struggle to do fair-value accounting because they are required to do so. And it does mean looking at market prices and trying to understand what is driving those market prices and how much risk is embodied in those prices.

So when we look at the private guarantee fees, we look for mortgages that are comparable in their risk to the ones the GSEs are doing. We make adjustments for differences in the borrowers and the houses and the leverage and so forth, and so we try to come around to the best estimate that we can make of the cost of those guarantees, taking into account the cost of market risk as it is reflected in market prices. Now, I would be happy to provide you with a more technical answer to the question later on if you wanted more details.

Mr. Garrett. That was pretty technical right there. But the bottom line is that there should be an evaluation or an appreciation of the fact that we are talking about mortgages here where there is market risk, and basically what CBO is try to go do is put that into the calculation, that the valuation of those things are going to change overtime, and that the obligation of us, the taxpayer, the federal government is going to vary because of that over time, and you are trying to price that today, so we understand what that cost is going forward. Is that not, in a nutshell, what we you are trying to do?

Ms. Lucas. That is it.

Mr. Garrett. Okay.

Ms. Lucas. Exactly.

Mr. Garrett. And absent doing that, you are really not giving a truly transparent answer to what the cost is to the taxpayers, and to the government today.

Ms. Lucas. Well, you are certainly not giving as comprehensive a measure of the cost. I mean the view that this is important comes from viewing the taxpayer as the ultimate bearer of the risk that is coming from this. So, if everything goes well, the taxpayers will be fine. But if we have another dip in the housing market, another recession, that is when defaults are likely to really hit, that is when those defaults are most costly, and that is the source of this market risk that taxpayers would require compensation to bear if they were investors. And that is the philosophy behind including that cost in these cost estimates.

Mr. Garrett. And Ms. Wartell, although you say that there is all this information out that is published in other reports, and what have you, elsewhere, there is also reports on everything else that federal government does elsewhere as well, but we still require the CBO and the OMB to actually put these things outside of here on budget so it is actually properly reflected as far as the obligations of the government. So why is it with just this one unique area that is satisfactorily that just because it is reported someplace else it is not prudent to actually list it as on-budget and what the cost is today? Why do you make this exception?

Ms. Wartell. Well, I do not think it is exception. What I was arguing, in fact, is that the cost to the Treasury of those obligations, what they will pay in future support under the contract that they have with the GSEs, which is the preferred stock purchase agreement, those costs are projected and they are on the budget, as well as the revenues that they anticipate receiving from the dividend payer.

Mr. Garrett. But the market risk is not on the budget?

Ms. Wartell. Well, the risk is embedded in the estimate of what those costs will be because those costs will vary.

Mr. Garrett. When you say that it is in CBO's estimate, it is not in OMB's estimate that is embedded.

Ms. Wartell. OMB's estimate has a measure of risk. The difference between CBO and OMB's estimate is whether or not they use a discount rate that is the rate that is charged to the Treasury, what Treasury obligations essentially can be purchased at, versus what a private actor would be charge because there is no private actor with this capacity; it is an estimate of what that would be. We do know what the Treasury rates are.

But the other problem is that the federal government is not a private actor; we know it is fixed costs, which are borrowing at Treasury costs; no one else has the capacity to borrow, and no one else has the capacity to spread risk. So what the use of that discount rate does is it is an attempt to estimate what the value of that risk is, but not necessarily the cost. That is the technical debate between analysts is to whether this is a more precise estimate of the cost to tax payers.

Mr. Garrett. I put my time in. Mr. Pollock, I will let you verbally have the closing word on this comment.

Mr. Pollock. Thank you, Mr. Chairman. The economist, Frank Knight, almost 100 years ago, famously and correctly distinguished between risk, which are odds that you know and uncertainty which means you do not know what is going to happen. As I interpret this discussion, it is about the uncertainty, which inevitably comes into the picture when you are extending credit and when you are financing things. So if you knew what the losses would be by a best-guess estimate, or estimated loss, and you knew that is what the losses were, then it would be very easy. You have the Credit Reform Act procedure. The problem is, not only do you not know it, you cannot know it. And I think, as I interpret, the CBO's recommendation is trying to correctly to take into account the inherent uncertainty that these losses may be much greater than anybody's previous best guess, we have experienced that many, many times. And there is one final point, which is the very fact that you think you know what the losses are going to be, as we just saw in the housing bubble, induces you to extend more credit, to run up the risk further and to make the losses bigger. And all of that, while hard to do in a precise way, is directionally what the CBO is trying to do, and I think that is correct.

Mr. Garrett. Mr. Van Hollen?

Mr. Van Hollen. Thank you, Mr. Chairman. Again, I want to thank all the witnesses for their testimony. I want to stay on the technical point for a minute and then get to the larger question of where do we go from here. And, Mr. Chairman, I do want to submit from the record the portions of the OMB budget, page 201; it talks about the market valuation, a plan sheet of Fannie Mae and Freddie Mac. And I understand Ms. Wartell's testimony to be those risks are embedded in their analysis and their projections. [inaudible] Ms. Wartell in your testimony, you talk about the fact that you are going to apply this other approach to measuring the risk and cost and that we need to do it uniformly across all credit programs. And just a quote from your written testimony: it says, "It would be irresponsible for Congress to cherry-pick individual credit programs to be subject to special budget rules. This would make some programs appear more expensive than others, when really they are calculated using entirely different measures of costs. It is like comparing two products priced in different currencies without considering the exchange rate." Could you elaborate a little bit on that?

Ms. Wartell. Yes, that reference was to the discussion about FHA and whether or not FHA, which is a federal government program, there is no controversy there, should be evaluated using the fair value method versus the methodology that is used under Federal Credit Reform Act. And I think they are two points there.

The first is it that consistency is enormously important because the ability to weigh the difference priorities of Congress requires you be able to treat like-items alike.

The second point is that it is perfectly appropriate for us to have supplemental information about FHA or other credit programs that get to this question of variability of risk because housing markets are different than energy markets that we also guarantee. But we should be looking at the cost to the taxpayers of those programs using similar methodologies.

Mr. Van Hollen. Thank you. Ms. Lucas would you agree with that?

Ms. Lucas. I certainly would agree with that. In fact, one of the stated purposes of the Credit Reform Act was to put credit on a level playing field with other commitments that the government makes. And I think one of those problematic things going on right now is the different treatments are being used in different places. Just to mention that Ms. Wartell said that what OMB is doing right now is it under Credit Reform, but for the GSEs it is actually using a cash basis of accounting in had the budget. So right now, we have an inconsistency between cash and even Credit Reform for the GSEs. So the GSEs, as they are being accounted for now, are not comparable with the FHA either in the way the administration is accounting for them. But certainly being consistent is extremely important. The GSE accounting is consistent with the way TARP was accounted for, and those obligations sort of arose in connection with the same problems that led to the TARP. So there was a consistency there, but there are inconsistencies in other places.

Mr. Van Hollen. Ms. Wartell, if you want to briefly respond to that.

Ms. Wartell. You are right about the reference to Fannie and Freddie. The question of consistency then determines whether or not you believe that Fannie and Freddie are like FHA in their current situation. Are we treating them consistently? They were private entities with private shareholders. They are now mixed ownership because the government owns a portion of them. But they are entities that are being wound down in their status. And we do not treat other entities being wound down like the banks that are on resolve by the FDIC that way. And so we have, in our striving for consistency, there are multiple facets in which we are striving to be consistent. And on that regard, the treatment of the GSEs, like FHA, makes them inconsistent with other things that are also not temporary in nature

Mr. Van Hollen. Mr. Chairman, I think members of this committee are getting a good sense of just how technical this issue is. That does not mean it is not important, it is. I think we would all agree we want the most transparent and accurate assessment of the cost to the taxpayers. And we obviously will continue to pursue that. But the larger costs in the long run has been said by some of our witnesses, and I mention in my opening statement is how we respond to the current situation because there are certain actions we could take that I believe would dramatically cost the taxpayer more both in terms of the obligations that we have already signed up to, but also would hurt the availability of credit for creditworthy borrowers going forward.

And so, Ms. Wartell, if you could just briefly explain what you think the consequences would be of three proposals. One, proposal is that introduced by Mr. Hensarling and a number of members of this committee. And the second, and I know Mr. Campbell has an interest in this, the one that he introduced that has bipartisanship co-sponsorship, and then the proposal that you have advanced at the Center For American Progress.

Ms. Wartell. Well I think the nut of the Hensarling proposal is an effort to unwind the GSEs but not to replace them with any form of targeted government liquidity backstop in the future and to do it quickly. And the speed is of particular concern because of the current fragile state of the housing market. If you were to disrupt the expectations of investors, people would worry now that a house that we buy today, no one will be able to buy or be able to get a mortgage on similar terms if there is no GSEs in the future. So they will be worried that they will not be able to sell it for what they purchased it for. That will deter purchases in the housing market and that will deflate values. So, my fear is that if Congress were to give serious consideration that to legislation, the market today would begin to price in some of those risks. And the effect of that would be to make our current economic fragility even more extreme.

The Campbell Peters Bill and others represent this notion that there should be a limited targeted liquidity back stop standing behind private capital that is fully at risk, meaning that the private investors have to lose all of their money before any government insurance and it also embodies the notion that there would be a charge paid for the government standing behind it. It would be built into the cost of the mortgage and the government would collect that money and hold it as a reserve fund, but would leave liquidity available, not for jumbo mortgages and high-end mortgages, but for the mainstream middle part of the market. So there is consistent availability that will allow house prices to resume their normal appreciation based on underlying economics. That approach, it seems to me goes a long way towards moving forward in the housing market. The cap proposal that was developed by our Mortgage Finance Working Group, takes nut of the Peters Campbell proposal, but also includes with it some obligations to ensure that all of our communities have access to credit. One of the consequences of this unfortunate foreclosure crisis is that particular communities that were targeted by some primary lenders are seen equity stripped and where there are high concentrations of foreclosures; it is going to take a long time for housing values there to recover. And so we create an obligation to ensure that the private market would serve all of our communities with access to credit, and to the extent they cannot do it profitably, there would be a shared risk with the taxpayers on budget priced under federal Credit Reform that we hope think will ensure that we recover most quickly but, at the same time, limit the taxpayer's exposure from the future.

Mr. Garrett. And then I guess it is appropriate to follow that line of questioning with the gentleman from California.

Mr. Campbell. Thank you, Mr. Chairman, and thank you all for being here.

It has been said many times there is no debate or discussion that Fannie and Freddie as they exist should be wound down. And that we want to account for them accurately and transparently, and that we want to reduce that cost to the taxpayer. Nobody disagrees with that. So I would like to focus on, obviously, the future and what we are going to replace Fannie and Freddie with and what consequences that may have. So Dr. Lucas, starting with you. If we have, as Ms. Wartell described, something that is an explicit permitted federal guarantee behind a lot of private capital, and for that guarantee there is a market charge, not dissimilar from FDIC insurance, the way that works, CBO, in that sort of instance, something like that could score at zero or little or low cost; is that correct? I am not asking to score the proposal at this time, but just in concept that kind of thing.

Ms. Lucas. It is certainly true that the more private protection there is in front of the government and the less likely it is that the government will see losses, the lower the estimated score would be.

Mr. Campbell. And you mentioned in your testimony about one of the problems that Fannie and Freddie is that there was no charge for what was implicit and became explicit. In this case, there would be a market charge.

Ms. Lucas. That is right. Unfortunately, the term "market charge" brings us squarely back to the ugly technical discussion we were having earlier because one person's view of what covers the cost to the government is different than the others. If, in my mind, a market charge would include a cost for the risk-bearing, and as you said, it would not be particularly large if the government was protected by a lot of private capital and by the value of the house and so forth, and good under writing.

Mr. Campbell. Okay. Let me go on to one other. If we were to withdraw any government support and wind down Fannie and Freddie and withdraw any government support, and that resulted in a drop in housing prices, that would put further taxpayer money at risk in the Fannie and Freddie portfolios that exist, correct?

Ms. Lucas. Yes, it would

Mr. Campbell. And that could potentially cost the taxpayer's money?

Ms. Lucas. Yes, it could.

Mr. Campbell. Ms. Wartell, I think you testified kind of to this degree that if we were to wind down Fannie and Freddie and replace them with nothing, no government support and the 30 year fixed rate mortgage as we know it vanished, which means that people would pay more money per month for the same house, and the only way that can happen is if there is a significant and matching decline in housing prices. And so, if that then occurs, it could cost the taxpayer a lot of money. So many by replacing it with a system, as Mr. Peters and I have introduced, we could actually be saving a lot of taxpayer money, both with the Fannie and Freddie portfolio, and in terms of what that kind of drop in housing, which is one-seventh of the economy, would do to the overall, very fragile recovery. Your comments?

Ms. Wartell. I would agree with that. I think that there is a real concern that our housing prices today assume the lesson we learned after the 1930s, which is that there will be consistent availability of mortgage credit that was built into the prior system with all its flaws. It did, in fact, until we had the explosion of the private label securities market outside of that system, we did, in fact, avoid bubble bust cycles. If we go back to a world out that consistent availability and the potential for bubble-bust, it will make people much more reluctant to invest. I would also add another point. I think that one consequence of that system, without any government liquidity backstop to an otherwise private market, is that a great deal more of the market would land in FHA. FHA is 100 percent government guarantee. That means that we charge premiums for it, but we stand behind the whole mortgage loss. There is no credit risk on the part of the lender. So it seems to me that that privatization scheme actually will shift a significant portion of the market to government with no private credit ahead of us. And that seems to me exposing us loss more loss, not less.

Mr. Campbell. Thank you, Mr. Pollock, and I have very little time, but you seem to stand out in believing that if we withdrew federal guarantee and had no replacement, that somehow that is not going to cause problems for the economy, for taxpayers and for housing, and that somehow the elimination of the 30-year mortgage, as we know it, or a 40 percent down payment, as you have suggested in some of your work, is somehow not going to have a very negative impact on housing, very negative impact on the economy, very negative impact on revenue, and therefore on taxpayers with their Fannie and Fred portfolio, come on.

Mr. Pollock. Let me back up a minute, if I may, Congressman and look at the result of the GSEs and the explosion of the agency debt, which was to create hyper-leverage in housing markets and housing finance markets, hyper-leverage in particular.

Mr. Campbell. Mr. Pollock?

Mr. Pollock. Wait a minute.

Mr. Campbell. And my time is over so, I do not know how the Chairman wants to handle it, but we are not proposing to replace the GSEs with the GSEs. No one in this room proposing that, so do not go to a failed model to describe what a future, different, entirely different model might look like.

Mr. Garrett. Let him answer your question.

Mr. Pollock. Congressman, with respect, I agree. We do not want to go to the failed model and we certainly do not want to repeat the failed model, neither the 30s model which created tremendous housing busts in the 1960s and '70s nor the GSE model. Remember that this theory of having private capital in front of government risk was exactly a theory of Fannie Mae and Freddie Mac and in the 1990s when their risk-based capital was set up, the theory was that this risk based capital would allow them to survive a new depression, obviously, it was all wrong. The government never prices risk right. It does not price in right in the FDIC. That has why the FDIC's net worth was vastly negative. It does not private it right in pension guarantees. It does not price it right in housing. It does not price it right in flood insurance. It never prices it right. What we need to move to, and where I think we would agree is we need to move in a coordinated transition, which we have suggested would be a five-year transition to solve the problems that you point to, problems largely created by the past mistakes of this design. We need to go through a five-year transition; the end point of which is, we move to a largely private mortgage market where the prices are market prices. I have no doubt there will be a robust 30 year mortgage in that market.

Mr. Campbell. That, no doubt, is not shared by anybody in the marketplace who might actually fund those 30 year fixed rate mortgages, by the way.

Mr. Pollock. With respect, we could discuss that later. And the final point would be we would bring the government, or we need to bring the government, as I said in my testimony, into control of its own credit, not hand it over to uncontrolled agencies which run around with the government's credit card.

Mr. Garrett. Thank you. I recognize the gentle lady.

Ms. McCollum. Thank you, Mr. Chair. In my district and throughout the United States, communities are still struggling. The repercussions of the housing crisis are still being felt by too many homeowners. And this is great reading, the financial crisis inquiry report. And so I am just going to kind of refresh the housing bubble here from page 422.

The housing bubble had two components: the actual homes and the mortgages that financed them. And they looked briefly at the components and it is possible causes. It goes on to say conventional wisdom is that a bubble is hard to spot when you are in one, and it is obviously painful later after it is burst. Even after the U.S. housing bubble burst, there is no consensus of what caused it, but they go on to list a couple of things that they went into detail: population growth, land use restrictions, over optimism, easy financing, and they go on to explain that.

Now, just recently, Standard & Poors found the single family homes dropped to their lowest level since 2009. Even more troubling to me is in the 20 metropolitan areas that they looked at, housing prices in the Twin Cities had the biggest drop, which is very unusual for the Twin Cities. Compared to March of last year, prices fell 10 percent in my community, making it the only area to see a double-digit drop. Well, it is important that we understand the causes of the 2008 housing finance market collapse. It is equally important that we enact smart reforms to ensure it does not happen again. There seems to be a consensus on part of the solution of restructuring Fannie and Freddie that in a way that protects housing opportunities for middle class families, but also limits taxpayer risk, as Mr. Campbell was describing.

The second equally important part is ensuring that Wall Street reforms passed last year are fully enacted. So the second part is where I want to focus on my question because I think we have heard a lot of talk about repealing the financial regulatory overhaul pass last year as well as weakening the consumer protection. In fact, Republicans who want to protect taxpayers from bail-outs, yet their budget intends to take the cops off the Wall Street watch here by cutting the SEC, the CTFC and completely eliminating the Consumer Finance Protection Bureau. So the very agencies charged with making sure that big banks that play by the rules which it comes to issuing mortgages and other credit products, there is no one watching the fox in the hen house. So I have a question, and my question is directed to you, Ms. Wartell. I am interesting in hearing what steps are needed in addition to reforming the GSEs to ensure that similar crises are avoided in the future, particularly what would happen to the housing market if Fannie and Freddie are completely privatized in the Dodd-Frank Act is not implemented. And after you are done answering that question, if there is any time remaining, I would yield it to the gentleman from California, if he has any further rebuttal to make.

Ms. Wartell. Yes, thank you. Representative McCollum. I would make two points. I think first of all as we were talking about earlier, if we simply unwound the GSEs with no replacement, I think we face a real risk of returning to the period of time of real wild swings in housing prices. Not simply regionally, as we have had in the pass, but nationwide. And that was the experience in the 1930s. The United States housing market enjoyed between the 1930s and the 1990s, certainly had ups and downs. But there was never time in which mortgage capital was not available. FHA was there as a backstop during the oil patch crisis. And that availability of crises helped to ensure that these swings were not as extreme. That allows people to invest in homeownership, have the community benefits that we get from homeownership and also the opportunity to participate in the well savings that homeowner ship has provided for American families, the fourth savings, if you will, that homeownership provides.

To your question about implementation of Dodd-Frank, I would just note that specifically as to the housing market, the Dodd-Frank legislation has a number of important regulatory actions that are currently pending. Members of this committee who feel strongly that we need to get the private market to be back bearing more of the risk in the housing market, have a strong interest in having those regulations completed. The qualified residential mortgage definition and the QM definition, the Qualified Mortgage definition, both of those are, right now, the private market does not know what the ground rules are going to be. When those regulations are in place, we will have clarity about the ground rules. And I think you will then see the beginning of private be label securities market serving the top end of the market and have the capacity as we withdraw the GSEs from the upper end of the market, to take over more of that. If we do not complete those rule makings, the ability to shift some of this risk from the public sector to the private sector will be limited. So I would argue implementation of Dodd-Frank is extremely important to getting the private sector to serve more of our housing market today.

Mr. Garrett. Thank you. The gentleman from South Carolina.

Mr. Mulvaney. Thank you, Mr. Chairman.

Very briefly a couple of comments. I want to get beyond the technical aspects of it and come back to what is actually happening here. Mr. Pollock, let me walk through these scenarios and tell me if I have got this correct.

If a private lender issues a non-conforming loan, say a jumbo loan, that has no government backing at all, and the homeowner defaults, just does not pay their mortgage, it is the lender who bears the brunt of that, correct?

Mr. Pollock. Correct.

Mr. Mulvaney. But the lender ends up losing their money in that particular transaction. However, if we are in a FHA back situation, the lender lends the money to the homeowner, the homeowner is unable to pay, tell me then, Mr. Pollock, who bears the brunt of that?

Mr. Pollock. The FHA.

Mr. Mulvaney. Which is ultimately the taxpayer of the United States of America, correct? And I think that is what is in a lot of this discussion, is that that is essentially what we are doing is that we are asking the taxpayers to help subsidize people who do not pay their mortgages. And I think that gets lost in a lot of the detail about this discussion.

What you have brought to my attention today, Mr. Pollock, was something I had not considered before, which was the indirect impact of the agency debt on the overall interest rate environment. Was it your testimony, I think that your estimate was some place between 30 and 100 bases points that we are paying higher on our public debt because of this huge agency debt. Did I get that right?

Mr. Pollock. That has correct, Congressman.

Mr. Mulvaney. And I think this committee has heard testimony several times from the CBO and other folks that an additional 100 basis points on what we pay for our debt when the debt is $14 trillion is roughly $1.4 trillion over the decade. So the taxpayer is paying there. And I think what we lose track of here is that we all talk about propping up the housing industry, and listen, I am a home builder, so I understand the importance of this particular industry to the nation. There is no question about it. But what we are doing is especially shifting a tremendous burden on to the taxpayer.

I want to address Mr. Campbell point very quickly and then I want to ask one question about the 30-year mortgage. Mr. Chairman, I would suggest that what my colleague from California is suggesting, along with folks on the other side of the aisle, is that this time we will get it right. We know we screwed it up before. We know we have done a really, really lousy job in doing this in the past and it is cost literally trillions of dollars. But this time, we are going to be much smarter in doing this than everybody else who has been here before. And that is all that I hear again. Is well, we know we screwed this up, but boy, if we do it right this time, it is really, really going to work, and Mr. Pollock, I think you hit the nail on the head when you said that government cannot do that because it does not know how to price risk. And that is because we do not price risk on a market-based assessment. We price risk on a political-based assessment. We make political decisions about what things cost as opposed to free market decisions about what things cost.

That is a lot of talking for me. I do have a legitimate question for everybody on the Board, which is I have heard a great deal of discussion about the possible existence or non-existence of the 30 year mortgage that so many of us are familiar with. I have heard arguments that it will go away if we get rid of the GSEs and do not replace it, and then I have heard arguments that it will not go away. I was always under the impression when I was in the industry that the reason for the 30-year mortgage was, in large part, because of the 30-year Treasury bill or Treasury note. And my understanding is that that is not go away any time soon. You all have a minute and a half each or a minute left each I would love Ms. Wartell to tell me why you think the 30 year is going away, and then, Mr. Pollock to tell me why you think it is not.

Ms. Wartell. The 30 year fixed rate mortgage requires a lender if there is not access to a secondary market investor or the ultimate investor to hold out their money for 30 years. And on terms, if it is fixed rate, that are set at the beginning of that 30 year period. That is a great deal of uncertainty about how interest rates will shift. And the most market investors are unwilling to leave their obligations out for that long without knowing where interest rates will go. They will at a price. And I think that Alex is right when he says that the 30 year fixed rate mortgage will be available, but it will not be available, in my view, at a price that most middle class American families will be able to afford. Those mortgages that Alex will cite that are available at that price tend to be for very, very high quality borrows with very high down payments. Most Americans do not have those terms and conditions.

Mr. Pollock. Congressman, there are private fixed rate mortgages that have 30 year terms. There has not been in this country a middle class private 30 year mortgage securitization market for prime mortgages. Now, this is a puzzle, which we will solve readily, but the puzzle is, it is the most logical market that should have developed as a secondary market prime 30 year middle class mortgages. Why do we not have it? Because the government, in the form of Fannie Mae and Freddie Mac, crowded out the private market. And there are big pools of money in this country and all over the world who are long-term investors who are looking for what we call long duration securities, duration and they buy long term corporates, they buy long term governments, they buy long term infrastructure bonds, they buy long term municipal bonds, and they will buy the long term mortgages as well.

Mr. Garrett. Thank you. The gentleman from New Jersey.

Mr. Pascrell. I want to thank the gentleman from New Jersey, chair?

Mr. Campbell, unfortunately, we, many of us on this side, not all of us, agree with your analysis, so I hope it does not doom whatever you are going to work at. We get the idea. We understand.

Ms. Rosen Wartell, you said on Page 8 of your testimony the Treasury discount rates are used for Credit Reform and an approximation of a private sector equivalent discount rate is used for the fair value reporting, and you discuss that on page 5 in your remarks. Regardless of whether they are discounted by Treasury rates or a private market premium, the cost estimates will still be grounded on the same market forecast. Biasing the estimates high will not change the economic reality in which FHA has to operate. It will, however, overstate the cost of operating the FHA program, so as to encourage misguided opposition and drive legislation to constrain its growth. But whatever the process, you say, it is imperative that Congress apply the same budget rules that FHA loan guarantees as it does to all other federal credit programs. Am I stating your position correctly? So I do believe in what Mr. Campbell has stated as an analysis of the program. I think your analysis is right-on.

I would like to know, Ms. Rosen Wartell, what would this piecemeal approach, which I am reluctant to embrace, and apparently, you are too. We have heard what it would do to the 30-year mortgage; you have been pretty specific about that. What would it do to the following three things: consumer protection, first-time home buyers, and multi-family units. Give me one or two sentences on each.

Ms. Wartell. And to be clear, this is not about scoring, this is about unwinding the GSEs in a piecemeal fashion.

First of all, I think one of the things the GSEs have done is they have provide standard terms and decisions for most of the market until we had the private markets take their place. Those standardizations help make it far easier for consumers to shop and compare. They could not do that during the private label subprime boom because everything was so confusing. That has hurts consumers, to first-time homeownership.

Down payment is the single greatest barrier to first-time home buyers. It is very hard for people to save, particularly with stagnant wages over the last decade, and the availability of low down payment lending to well-qualified borrowers will be made more difficult in the world that has been described.

Mr. Pascrell. Excuse me, what exactly would be made more difficult?

Ms. Wartell. If we have only private investor loans at a price affordable to home buyers, low down payment lending, lending that requires five percent down payment for borrows who are otherwise well qualified, who have good credit, will be far more difficult to get, the prices would be higher. I think the availability would be diminished. For multifamily, it is very important to remember that the GSEs during the crisis also provided an enormous amount of liquidity for the rental market. For demographic reasons, we are going to see a huge increase in demand for rental housing over the next 20 years, and we have had a complete shut down in the supply for a significant period of time. One of the reasons families with three kids bought homes was because there was not decent rental housing that they would afford and so they stretched themselves to become homeowners. Without a mechanism for liquidity for long-term finance for rental housing, we will also see increasing pressure on rents and difficulty in homeownership.

Mr. Pascrell. Okay, thank you, so much. Mr. Pollock, how would you expand consumer protection in your protocol?

Mr. Pollock. Thanks Congressman. First of all, let me say, I believe the greatest obstacle to first-time home buyers is inflated house prices. And inflated house prices reflected among other things, all the government subsidies flowing into housing so we are doing a disfavor to first-time home buyers by subsidizing house prices; so one way to protect them would be to not do that.

Secondly, I have discussed for years a theme, which the Nasant Consumer Financial Protection Bureau has picked up, which is simplified, clear, straight-forward mortgage disclosure, which I do think would be a major improvement. You certainly do not need a new government agency, which is free of the discipline of appropriations to get that, but to get that simplified disclosure; I think is something that we could all agree on. It turns out to be hard to do to make things clear and simple, but it can be done.

Mr. Pascrell. Thank you for your contribution. Thank you, Mr. Chairman.

Mr. Garrett. And I thank the gentleman from New Jersey. Gentleman from Indiana.

Mr. Young. Dr. Lucas, I believe it was Ms. Wartell who spoke earlier of the incongruity of using one sort of accounting analysis for one particular government program and then a different sort of accounting analysis for a different government programs. Why in your mind is it appropriate to use a fair value analysis for the housing market and using a unique accounting method just for this sector in terms of how government keeps its books?

Ms. Lucas. Okay. I did not mean to imply that it is appropriate to use a unique accounting treatment for any sector, and I believe that we want to move towards an accounting treatment for all credit obligations that give Congress the best picture of what their true cost is. The way that we got to fair value where the GSEs really started, I think with the treatment of TARP, where our fair value was required, because it was possible that TARP would have appeared to make money for the government, which did not seem like, perhaps the best way to account for it.

So for the GSEs, there was a number of considerations, many of which are legal, many of which I do not want to go into detail on because I do not think I am the best qualified to describe it. But basically, the GSEs were difficult. They did not fit into any natural bucket. The budget has two choices, basically, cash and Credit Reform. Cash did not seem appropriate for the reasons I discussed in my testimony. It does not give a sense of the obligations going forward and so forth. The Credit Reform Act was also problematic. There were some contradictions between the GSE's charter acts and the Credit Reform Act that did not quite reconcile. But beyond all that, I think that that fair value treatment does give the most comprehensive picture of what the costs are, and that ultimately was why we settled on that for the GSEs.

Mr. Pollock. Chairman, could I just add a footnote there? It is my view that there is a big difference between the housing finance activities of the government and these other things, in that the housing finance activities are so much bigger. So in a day when the total agency debt was 15 percent of the Treasury market, you probably did not care that much. But when it is as big as or bigger than the whole outstanding stock of direct government debt, you care a lot. And I think it gives us good reason to focus on them independently as opposed to a lot of many smaller things.

Mr. Young. It would seem logical and consistent that, frankly, in other sectors, in other areas of government-backed finance, we would also try and incorporate market risk, right? I mean, that is a counter to the argument that I frequently hear, which is that we have an inconsistency here. Perhaps we do. Maybe all the more reason for its embracing a fairer value sort of method of accounting for other areas. But I know that broadens the conversation here.

Mr. Pollock, under the current cash accounting method, the FHA uses, government makes a profit. That is correct, sir, right, according to our books?

Mr. Pollock. Well, actually, what FHA does under Credit Reform is to estimate its future losses, which is a kind of an accrual, and have to book those. Whether you call it a profit or not is a little tricky because we do not charge the FHA in the accounting for their operating expenses. Those are separately appropriated and separately budgeted. So all these numbers we have been talking about, unlike with a normal company, or a normal insurance company, we do not count the cost of actually operating the programs, as the CBO correctly points out. So one of the things I would like to see as a supplementary FHA account would be a set of GAP books that actually measures the profit and loss of the insurance business of the FHA the same way we would measure any other insurance company.

Mr. Young. It seems curious to me, could not the government actually improve its balance sheet if we mandated that the United States government had to insure every loan in the mortgage marketplace, right?

Mr. Pollock. Well, that is the reductio ad absurdum, if I could use the reduction to absurdity of the argument that, of course, we make profits and the more we guarantee, the more profits we make. And of course, the more we do that, the less market discipline, the less efficient is our resource allocation, and the bigger the ultimate collapses tend to be.

Mr. Young. Thank you. And for the record, I was not suggesting that we do that.

Mr. Garrett. The gentleman from California.

Mr. Honda. Thank you, Mr. Chairman. I want to thank the chair and ranking member for convening this panel and for the panelist being here. It is my hope that our community can use hearings like this to engage in a serious discussion about the housing market. We have seen too many debates on serious issues hijacked by the special interest agendas.

For example, in this committee, a budget was reported to claim to tackle the deficit and did, but really represents an agenda to privatize Medicare and block Medicaid in order to pay for more spending tax on charity for the top two percent of our earners. This is unacceptable.

We are facing serious economic issues in this country that Congress must address. The eyes of the nation, and indeed of the world, are upon us. Today we have two critical questions to address: First, republicans have single mantra regardless of the issues, deregulate, deregulate, deregulate, the market will police itself. Will completely deregulating the housing market prevent future crisis? I think everyone, Democrats, Republicans, understands that certainty is a key ingredient for a high-growth economy. So my colleagues across the table would like to wind down Fannie Mae and Freddie Mac. However, given the increasing income inequality in our country, and I will say that again, given the increasing income and equality in our country, when the median income for 90 percent of families is around $30,000, given these factors, under the Republican proposal, how will the bottom 90 percent buy homes in the absence of Fannie Mae and Freddie Mac, and will they be able to obtain a 30-year mortgage at reasonable rates? I may like to start with Ms. Lucas and then Mr. Pollock and then end with Wartell.

Ms. Lucas. Okay.

Mr. Honda. You have a minute each.

Ms. Lucas. Okay. Well CBO really has not done an analysis of what the affect would be of reducing the subsidies to Fannie Mae and Freddie Mac. It is clear that if they were less subsidized, the cost of borrowing would go up to some extent. There has been some estimates that range from just a few bases points to over a percent. Whether that is a good or a bad thing, I think depends on the perspectives, and I am going to let my colleagues on the panel give those perspectives.

Mr. Pollock. Congressman, in my judgment, these median income families will be able to buy houses and with mortgages in a market system with market prices. You mentioned regulation. I would like to point out that one of the reasons why house prices are falling right now and why the housing market is so soggy is the natural regulatory overreaction in the wake of the bust, which has had the effect of make mortgage credit much more difficult to get because the lenders are terrified with their increased legal and regulatory risks of even making a loan. So I am sure we have all heard endless anecdotes about people with good credit who are put through the most outrageous process even to get a loan. And when the credit is tied up in this way, it makes it harder for anybody to buy a house. We see this cycle after cycle, that in the wake of the bust comes a regulatory overreaction of clamping down excessively which makes recovery from the bust more difficult.

A second reason that I would like to point out why we have continuing serious problems is exactly the 30-year fixed rate mortgage. The 30-year fixed rate mortgage is an instrument, which if housing prices are inflating, works very well. If housing prices are deflating, it is a terrible instrument. It locks people into high mortgage payments which they cannot get out of. And when they do not have the equity to refinance, they are trapped in the mortgage, so we have endless programs of trying to modify and change the rates on the mortgages to reflect the current market, which do not work very well. So we do need to understand these underlying causes of our current problems. Thank you, Congressman.

Mr. Honda. Okay, Mr. Chair I would like to have Ms. Wartell.

Ms. Wartell. For the medium income family that you describe, the availability of long-term finance allows them to set their housing prices. If they were subject to only affordable adjustable rate mortgages, they would recognize that as interest rates fluctuate, their housing costs could suddenly grow dramatically. The transaction cost for a family to move their home because their housing just got more expensive is far more difficult than it is for investors to adjust their portfolios in different interest rate environments. So it is the availability of the long-term finance that I think is so important to the median income family.

Under Mr. Campbell's bill and my own proposal, the cost of the subsidy the GSEs got would be priced in the future, which means housing costs will go up a little bit. And everybody thinks that is appropriate. We should not have a hidden cost to the taxpayers. But what is important is the consistent availability of credit to allow people to make investments in homes.

Mr. Honda. Thank you.

Mr. Garrett. Gentleman, yield back. Gentleman from Indiana.

Mr. Rokia. Yes. Thank you, Mr. Chairman. I appreciate the witnesses coming today. I have enjoyed listening and have one, maybe two questions, if I can get them in.

First, to Mr. Pollock. Earlier this year, Dr. Carmen Reinhart, you may be familiar with her work, testified in front of this committee. She has done extensive work on debt burden, specifically in countries or models that have 90 percent debt to GDP ratios, and what the negative impact on economic growth is. One thing she talked about was that not only does public borrowing rise precipitously ahead of a sovereign debt crisis, but that the governments involved when this happens, are often found to have, quote-unquote "hidden debts." Mr. Pollock, from your testimony, you would say that the U.S. has hidden debts, right?

Mr. Pollock. That is correct Congressman.

Mr. Rokia. Okay. What is the impact of GSE and other agency debt, so not just GSE, on your fiscal solvency? All right, I am getting a little way from Fannie and Freddie here, as our debt held by the public approaches the high levels that Reinhart discusses in her analysis?

Mr. Pollock. I should say that Carmen and her husband are good friends of mine and we share many approaches to understanding financial cycles. When any borrower is running up his debt, it is very tempting to try to put the debt in an off-balance sheet way, that we observed again and again in private markets, and it is also observed in government markets exactly as you suggest. So the curious thing about the explosion of agency debt over the last four decades is precisely this creation of a debt that really was not hidden, I mean, we knew it was there, but it was hidden in terms of the official way we talk about the debt. Among the results, being much more risk to the taxpayers, a higher cost to financing the Treasury. And I reiterate my recommendation that we out to require the Treasury to provide an annual report to the Congress on the extent to which agency debt has made Treasury debt for expensive or has affected Treasury debt, and on the overall credit worthiness of the government. And I reiterate my representation that we ought, in statute, explicitly to make the Treasury responsible for managing the overall credit worthiness of the United States, and that means they have to manage the debt of these mixed ownership government corporations, like, Fannie Mae and Freddie Mac. Or, we just have to recognize the reality.

Mr. Rokia. Thank you, Mr. Pollock. And I said this was a question to Mr. Pollock, but I was wondering now if CBO wants to comment on the same set of questions?

Ms. Lucas. CBO has published various reports that talk about different measures of the debt, and certainly the public debt is the public debt. But these other obligations affect the fiscal situation of the United States.

I think it is important to think about the sum of the two, as Dr. Pollock has. I think it is also important, though, to recognize that not all debt is the same. So the debt of the GSEs is backed by the mortgages that are making payments on that debt. So it is not quite the same thing as debt which is just backed by tax revenues from the citizens. So it certainly matters, but it has to be a little bit careful.

Mr. Pollock. Just like the SIVs of Citibank.

Mr. Rokia. Say that again, please?

Mr. Pollock. Just like this term SIV, SIV stands for Structured Investment Vehicle.

Mr. Rokia. Oh, thank you.

Mr. Pollock. Just like the SIVs of Citibank, I said.

Mr. Rokia. Right, thank you.

Mr. Pollock. I was having some fun with my good friend and colleague.

Mr. Rokia. I was going to ask you if you had a reply to that. A serious one.

Mr. Pollock. Well, no, I agree we have to look at the whole picture just as any entity looking at its finances has liabilities of different kinds. But you have to tote up the total liabilities and figure out and control their effect on your credit worthiness.

Mr. Rokia. Okay. Thank you, very much, Mr. Pollock. And then, Ms. Wartell, not to leave you out. And if you want to quickly comment on that you can. But I have interest in this rent versus buying.

Mr. Garrett. Would the gentleman yield?

Mr. Rokia. Sure.

Mr. Garrett. Ms. Lucas, you said it is all the debt is backed by mortgages?

Ms. Lucas. Well, I was just noting that the debts that the GSEs have issued was issued in order to purchase mortgages.

Mr. Garrett. But not their entire book of all their debt is backed by mortgages, correct?

Ms. Lucas. At the time when they issued the debt, they are issuing it to purchase a mortgage. Some of the mortgages have since fallen in value. And so there is a gap between the value of those mortgage assets and the liabilities of their debt. And that is gap is what is reflected in those costs of the business that they already have. I did not mean to say those were not real costs, only that when you have an asset as well as a liability, the existence of the asset can change your view of the liability and what it does to the stability of the financial situation of the country.

Mr. Garrett. Yield back.

Mr. Rokia. Thank you, Mr. Chairman. Just real quick with Ms. Wartell. I am intrigued by the concept that we are starting to realize now that maybe not everyone should be, or has to be, a homeowner in order to realize an American dream. Maybe the American dream evolves and changes. Do you think the history of pushing people to buy homes has distorted markets and that perhaps not everyone should own a home?

Ms. Wartell. I think there is widespread consensus that federal housing policy has been imbalanced, that we need to get the balance right, that we need to make sure that there are appropriate housing choices for everyone at their stage of life and with their family conditions. That means we need to ensure there is credit availability to finance rental housing and that that are good rental housing choices.

Mr. Rokia. Thank you.

Ms. Wartell. Absolutely.

Mr. Rokia. Okay. Thank you, ma'am.

Mr. Garrett. And I thank you. And the lady is recognized as soon as the light comes on.

Ms. Kaptur. Thank you, Mr. Chairman. I want to thank our witnesses very much, and our committee for at least providing us the opportunity to talk with one another across party lines.

My two main questions are, and I am going to make a statement after the question so you can think about the questions, six banks in our nation now control two-thirds of our banking system. How do we restore real competition for mortgage credit? And number two, how do we restore prudent mortgage lending and origination that recapitalizes local and regional community financial institutions, not distant speculative lenders? Some, as you have heard this morning want to blame Fannie Mae and Freddie Mac for the financial meltdown. And I would like to put their role in perspective as I see it. They were doing fine until deregulation of private financial markets occurred during the 1990s and what we have experienced now in this past decade is the government has become the dumpster for the mistakes of the private sector and the cost are enormous.

High-risk behavior in America's housing market began during the early 1990s when financial deregulation pushed by some here in Congress, allowed the private financial sector to turn formally prudent mortgage loans into bonds and then securitize them into the international market in a manner that bore no relationship to true value nor the local real estate market. I would like to place in the record an article from this week's New York Times, the "Good Banker," by Joe Lucera. There are many good bankers left out there. They need to come before our committee and help us figure out a better future for this country.

I remember in the early 1990s when the largest commercial banks, and later Wall Street's speculative investment houses came up here and applauded the demise of the staid thrift industry and its conservative mortgage lending practices as the big Wall Street banks hungrily sought after a globalized market, and after the housing market, that they had not been into as a new national profit center. I recall when the sign outside the door of the former Banking and Housing and Urban Affairs Committee was taken down and that committee renamed the financial services committee. That signaled a new era of abandonment of strict practices in mortgage loan origination and standards of prudent lending that had regulated private sector mortgage behavior for most of the 20th Century, following The Great Depression.

In fact, during the 1990s, the securities jurisdiction of the energy and commerce committee was merged under that Financial Services Committee as Congress passed, without my support, the Leach-Bliley Act. And when the Glass-Steagall Act that it separated banking and speculations since 1933 was wiped off the books in 1990 under that Leach-Bliley Act, the speculators were unleashed full bore. I have a bill, H.R. 1489 that would restore important Glass-Steagall provisions.

Fannie Mae and Freddie Mac were not the quarter backs in this game of market manipulation, Wall Street was. But Fannie and Freddie were very important wide receivers in this high-stakes big bank hyperventilation of the mortgage market. The private sector big banks and speculative houses soon discovered that home mortgages were pretty sleepily instruments with a 30 year pay-back time horizon that did not yield the quick seven-year pay back of commercial loans or speculative prospects. So the big banks and their minions and the origination servicing and rating industries figured out how to inflate their returns. I would like to place on the record a few pages from the back published in 1996 by former chairman and CEO of Fannie Mae, James Johnson, entitled Showing America a New Way Home. In it, he clearly described what the private sector was up too: transforming the way America financed home buying, the mortgage system, from an industry that is almost exclusively dependent on depositors to one that is investor-based. He lauds the fact that capital to finance homeownership will be virtually unlimited, I am quoting, "unlike the former savings and loans, and that international capital markets will now assume the risk, and our superbly well-equipped to evaluate performance as they invest in securities backed by mortgages." Fannie Mae and Freddie Mac were wide receivers in this transformation, but the quarterbacks sat on Wall Street and on the Board of Federal Reserve.

Looking back, it is hard to understand how he could have such unguarded faith in an untested system of the deregulated global private financial marketplace for housing finance. But that is what happened. And Fannie Mae and Freddie Mac then adopted high-risk practices too, becoming key agents to move this mortgage paper into international tranches.

For our nation to dig itself out of the worst housing depression since the Great Depression, we must go back and unwind what happened and restore prudent lending standards again. I have a bill, the Fannie Mae and Freddie Mac Investigative Commission Act. It is a straight-forward piece of legislation that creates an independent commission to investigate and analyze what policies practices and board decisions on risk management that were made at Fannie Mae and Freddie Mac that led to the enterprises financial instability and the subsequent conservatorship of the two entities. This commission would build on the work of the Financial Crisis Inquiry Commission as a basis for, again, disciplining the financial practices that led our nation to such a precipice.

I have many, many documents to enter into the record and Mr. Chairman, I will wait for the second round for them to address the two questions I have asked about restoring competition in our banking system. Again, and recapitalizing local markets that are capital-starved at this moment.

Mr. Garrett. And the gentle lady yields back and as the gentle lady indicates as long as our panel's available, we are going to do, at the request of some of the members, a second round. And we should probably put the caveat to members that are here too, since these members have been sitting here through all this.

I will yield at first to the gentleman from California.

Mr. Campbell. Thank you, Mr. Chairman. Mr. Pollock, well, we have to have a little discussion about some of the things that obviously, that you and I disagree about.

In your comments and responses to the gentleman from Indiana, I believe I heard you advocate for lower housing prices, correct?

Mr. Pollock. Congressman, first of all, let me say I really look forward to a discussion when we get a chance in person to go over some of these things. I know you are very knowledgeable on these topics and I would look forward to that a lot.

Lower housing prices are obviously good for some people, mainly the people who are buying houses, especially the first time home buyers. They are bad for people who bought the house previously at a higher price. They are like the price of anything. When it goes up it is good for the people who are long, and when it goes down, it is good for the people who are short.

Mr. Campbell. Yes, but I believe I heard you say that you thought they were too high and that they were artificially propped up and that this was hurting new home buyers and that we out to let them fall.

Mr. Pollock. What I was trying to point out was that in the housing bubble, we, without question, artificially inflated house prices to a great extent.

Mr. Campbell. Okay, how about now?

Mr. Pollock. And I think they are probably now in my own forecast, they are coming across a long and rocky bottom, where house prices will be falling in real terms but moving in an irregular flat line in nominal terms.

Mr. Campbell. Okay, that is what you forecast. But you think it would be good if they dropped some more?

Mr. Pollock. The specific point I make is that the gentleman asked about what is an obstacle to homeownership for first-time home buyers, and I said high house prices, inflated house prices are such an obstacle. There are other obstacles, of course.

Mr. Campbell. You know, we out to switch places because your very good at not answering the question that supposed to be our job. But I heard what you said before to the gentleman from Indiana. Now I think maybe I get it. Because if you believe that a fallen home prices is okay, then having no government support for the system, which will trigger that, and that is okay. But the recession, or near depression, that we had in 2008 was triggered by 28 percent drop in home prices. I do not want to do that again. I do not want to see that again. The home market is one-seventh of the U.S. economy and it is already holding back this recovery and we are not going to get any kind of recovery if we do not have a robust housing market, and removing that support and triggering another significant drop is just going to move us into recession, which in terms of the Budget Committee that we are talking means less revenue and it means that all these Fannie and Freddie debts, which none of us are happy about but we got them, I mean the taxpayer has them, and further declines in home prices, I think there is no dispute about that is going to cost taxpayers a lot more lost money on Fannie and Freddie portfolios that we already have. You like to comment on that?

Mr. Pollock. Yes, sir, I would love to Congressman. Thank you very much.

First of all the trigger, of course, for the fallen house prices was the 90 percent inflation in house prices, which made the subsequent fall absolutely inevitable. The fall was about 30 percent of the peak, which is about 60 percent of the base.

Mr. Campbell. Okay, Mr. Pollock, you always want to go back and talk about that. I want to talk about where we are now and where we might go now.

Mr. Campbell. And if I am wrong on this, say I am wrong, but your concept of what you want to do going forward will result in a drop in housing prices, and you are okay with that. Is that correct?

Mr. Pollock. I think that is not correct. My view is I think it would be correct if our proposal were to happen in five minutes. But since it is a five year transition, I think it is not correct.

Mr. Campbell. What if the five year transition is not correct?

Mr. Pollock. The very point of a five year transition is to leave the financing, which is now in place, with the support of the government and the taxpayers to get us through the transition out of the bust, which is unfortunately necessary because of the bubble.

Mr. Campbell. Okay, well, Mr. Pollock, I just in my final 22 seconds, you know, my conversations with the people who would lend the money, I know you seem to think that there be 30 year fixed rate mortgages without government support. But, you know, we do not have to speculate. That exists. There is the non-conforming market, the jumbo market out there right now, and as Ms. Wartell indicated, you can get a jumbo loan at a 30-rate fix with, like, 50 percent down. And if that is the place we are going and that is what it looks like and that is where your proposals would lead us, that is going to make the last housing drop look small. And that is why we cannot afford to have that happen. I yield back. Thank you, Mr. Chairman.

Mr. Garrett. Ms. Kaptur.

Ms. Kaptur. Thank you, Mr. Chairman. I am very interested in your comments on my statement. That has how I view the world. Two questions: six banks in our country now control two-thirds of the system. What do we do to restore real competition for mortgage credit, just taking that piece of the credit system? And secondly, how do we restore prudent mortgage lending and origination that recapitalizes local and regional community financial institutions, not just in speculative lenders? Yes, Ms. Wartell?

Ms. Wartell. If I may, thank you, Ms. Kaptur. I think that having a system of housing finance in the future that ensures access to the secondary market for community-based financial institutions is one of the goals of the kind of proposal that cap has and could well be achieved under representative Campbell and Peters legislation with some minor adjustments.

It is a great concern to me that we have such concentration and a very small number of lenders. For origination of so much of our mortgage market these days.

Ms. Kaptur. Will the gentle lady yield just for one statement? And also a group of individuals and institutions that have no respect for the local real estate market. When they end up owning these homes and holding these homes, they do not take care of them. Plumbing is ripped out. What is going on across this country is a disaster.

Ms. Wartell. In a fully privatized world, where access to the secondary market where the lender's ability to sell, the larger financial institutions will have a far greater ability to access the secondary market as many of them develop their own private label security origination schemes during the last bubble.

My concern is that there is a mechanism to ensure that small banks and community-based institutions like CDFIs and others have access to the secondary market. Our proposal includes a requirement that those who insure mortgages and package them for securitization should not be originators of those mortgages except to the extent that it is in the form of a co-op of originators, so that we can ensure that a wide array of financial institutions have that access. That will, I think, in part address some of your concerns that community-based lenders can effectively compete against these large institutions.

Ms. Kaptur. May I ask, you assume securitization is fundamental to the housing system of the future?

Ms. Wartell. Yes, I do. I think if you were to take the size of the housing market today and imagine putting that on balance sheet of our current financial institutions, it would dwarf their capacity to lend and it would collapse access to capital for other parts of our community.

Ms. Kaptur. But how do we strength local institutions as opposed to these very irresponsible distant institutions in that scheme? I am not sure I support securitization as the only option for the future.

Ms. Wartell. I do not support it as the only option. I think we need to go back to a world in which we have securitization and balance sheet lending as we did in the past. Some of that securitization needs to be like FHA lending for targeted borrowers and some can be private with private capital risk, but access to the secondary market through liquidity backstop and some of it needs to be fully private. But what we need to do is have appropriate regulation to ensure that lenders throughout our economy, large and small, can access those markets.

Ms. Kaptur. Thank you. Mr. Pollock, you have been waiting to say something.

Mr. Pollock. Congresswoman, I have to say, I enjoyed your comments so much because it makes me think of one of the great proofs that economics is not a science, and that is that whatever happens, we can have mutual inconsistent interpretations of the events and neither side can prove its story. And by the way, Congressman Campbell, I really look forward to some further discussions. I know we will find something we agree on.

Mr. Campbell. And I go too. I failed to mention that, but I look forward to further discussions as well.

Mr. Pollock. I have until the course of my career worked for big banks.

Ms. Kaptur. I noticed that.

Mr. Pollock. And I ran a thrift. So I have some experience with that.

Ms. Kaptur. Yes, you were on Federal Home Loan Bank Board.

Mr. Pollock. And a federal home loan bank. The thrifts, of course, were extremely heavily regulated and, nonetheless, collapsed. When I was with the Federal Home Loan Bank of Chicago, we made the observation that you could find a regularity in the mortgage market, and that was that the mortgages originated by small banks and thrifts had consistently higher credit quality than those originated by all other originators. And we set out to give them a better way to finance these mortgages because we used so say to them, and what do you think the credit quality of your mortgages is? And they would say, "Excellent." And we would say what do you think your charge-off on your customers, your local mortgages? And they would say, one bases point a year, or something. So we said, well, in that case, why did you want to pay 25 bases points to Fannie Mae and Freddie Mac to divest the credit of your own customer? That does not make sense. And they would say, "Yeah, I never thought about it, but you are right." They war basically being overcharged for the transfer of the credit risk consistently for decades by Fannie and Freddie.

So what I would like to see is a way for small banks to be more robust competitors in the credit sector of the market where they are demonstrably extremely competent actors, where they could retain the credit risk, be paid for retaining the credit risk, but have a way to finance the interest rate risk. We actually have designed program like that, which I think much more could be made of if we set about it rightly because we have a set of actors in our 6,000 or 7,000 smaller banks that make mortgage loans and whose local credit talent, we need to take much more advantage of.

Ms. Kaptur. I am so glad you came today. We probably do not agree on many things but I want to thank the Chairman because I think this is very valuable. You know, members of Congress do not talk about this very much. The whole housing sector and it is terrible role in bringing our economy down after the rising gas prices triggered the whole mess and the rising oil per barrel back in 2008. But it is really sad that this institution has not met its obligation to the American people when you look at what has happened over the last three or four years and the hemorrhage that is going on across this country. So I would just encourage the Chairman to bring them back with a brown bag lunch and let's talk about their experience. Because somehow these discussions are not occurring in the Senate, they are not happening in the Financial Services Committee, maybe this Budget Committee could do the country a favor. We need to take the best talent we have, take the bills that are being proposed and actually try to do something on a bipartisan basis to move forward. Now, I am very concerned about the future and about our credit system, certainly for mortgages and about the hemorrhage in this housing market that is devaluing these assets and destroying these assets as we sit here today. So I would just ask the Chairman to think forward and, you know, I would be willing to work with you and our chairman, Mr. Van Hollen in that effort.

Mr. Garrett. And I thank you. And I know you have been very interested in a leader on this issue and just one differ is that, yes, we have actually been taking up these issues in the Financial Services, at least in the Capital Markets Committee, as some of these members have been here on that.

But I look forward to the idea of coming again and exploring them. Gentleman from Indiana.

Mr. Rokia. Thank you, Mr. Chairman. Just picking up a little bit on the question I asked Ms. Wartell about the American dream, and this came out in of the exchange you had with Representative Campbell, Mr. Pollock, the idea that our economy somehow revolves or orbits around the idea of housing starts and homeownership, and we can discuss the definition of the American dream and if it should stay the same or if it should evolve or if politicians of both parties have forced the American dream by distorting the free market system instead of allowing Americans to earn the American dream. But can each of you point to any economic and empirical data, not cultural or political rhetoric, again, economic or empirical evidence of why the economy should be based on homeownership or home starts or home building, or anything like that, I receive a good deal of support from the Home Builder Associations, so I am sure I am going to be in trouble for this, but we have to be honest as Ms. Kaptur says, and if we are going to ask these questions, figure out why it is that it has to be this way to the economy to center itself around home building and homeownership. Ms. Lucas?

Ms. Lucas. Okay. Well, from an economist perspective, it does not have to be centered around it, it is an important part of the economy.

Mr. Rokia. Why?

Ms. Lucas. Because people want and need good places to live. So I am a little perplexed by the question. There needs to be homes.

Mr. Rokia. I am talking about homeownership.

Ms. Lucas. There is a role for rental housing and there is a role for homeownership, and there are other countries where rental housing plays a significantly larger role and people seem to get good housing services through the rental markets there. So it is true that your economy has sort of moved in the direction of heavily favoring homeownership and we could be organized in different way, but where we are right now, is that it is a large faction.

Mr. Rokia. Okay, thank you. Same question.

Mr. Pollock. Congressman, if you look around the world and homeownership rates vary a lot among countries, among developed countries. The U.S. is sort of in the middle of the pack in terms of the percent of households who are homeowners who are neither the highest nor the lowest. An interesting country is Switzerland, a very rich, pleasant country, which has very low homeownership, perhaps in consistent with your hypothesis here. It also has a central bank whose shares are publicly traded or the citizens can buy shares in the central bank, an interesting concept by the way. My view would be that obviously shelter is a very big and very important sector and that people ought to exercise their preferences to own or rent as they like and as they are able, and many people will like to own and will be able to own. Others will like to rent and that that should be a market outcome left to the voluntary exchange of the citizens.

Mr. Rokia. I note your term voluntary.

Ms. Wartell. I largely agree with Alex and since that does not happen that often it is worth noting. But I would note that in our society, we have created a system that uses housing as a principal form of savings for American families. And people essentially pay down their mortgages over time and they receive significant tax advantages for doing so. So we are, in a sense, encouraging that savings and that wealth accumulation and that wealth accumulation allows families to both invest in small businesses and educations of their children, as well as provide for their own secure retirement when they are no longer earning. We could make a policy decision not to encourage savings in that form and to do that differently, but those are very fundamental changes in the way our tax code operates and our housing system has been built.

Unfortunately, we have created that set of incentives but we have only allowed some to participate in this. And so we have enormous disparities in wealth in our society, especially on our racial grounds but on a wide array of grounds, including geography, and so that some people are getting the benefits of those subsidies and that encouragement of homeownership and others are not. Unless and until we are prepared to say that we do not want to encourage homeownership, then it seems to be important that we ensure access to homeownership as a means of accumulating wealth and to give access to the opportunities to grow businesses, to educate children, and to have a secure retirement.

Mr. Rokia. Thank you, Mr. Chairman. Very educational. Yield back. Thank you witnesses.

Mr. Garrett. Gentleman yields back. Gentle lady from Florida.

Ms. Wasserman Schultz. Thank you, Mr. Chairman. My question is for Ms. Wartell. Would you agree that one way federal government can assist in stabilizing the housing market is by helping to prevent avoidable foreclosures?

Ms. Wartell. Absolutely.

Ms. Wasserman Schultz. I am from the state of Florida and, you know, right now we have many homeowners who are locked into high interest rate loans and they do not have the ability to refinance, they lost too much equity, many of them are upside down. Four and a half million borrowers with outstanding mortgage loans in Florida are in that situation;

2.1 million owe more than the value of their home; that is 47 percent of the population in Florida. Nearly 20 percent of underwater mortgages in the United States involve Florida properties. So allowing homeowners to refinance and lock in historically low rates would help a lot of people be able to stay in their homes. Our colleague, Dennis Cardoza from California, has introduced legislation, and I do not know if Mr. Chairman, that has been spoken about already. But, he has introduced legislation called "The Home Act," the Housing Opportunity and Mortgage Equity Act: And that would require Fannie Mae and Freddie to allow homeowners to refinance those mortgages. So rather than pull the rug out from under the housing market, is there not a better solution, like this one, for stabilizing home prices?

Ms. Wartell. I think finding ways to avoid avoidable foreclosures has got to be an enormous priority in efforts to stabilize the market. I am not familiar with that legislation, so I would rather not comment on it now without looking. But I would say that there are a couple of different strategies that are useful in that. One thing we have written about in the past is mediation, which requires lenders before they foreclose to sit down with the borrowers and consider seriously, with an advocate on their side before they foreclose. Nothing forces them to do a modification but gives them another bite at the apple. There have been models in a number of states that have been very successful in showing that lenders actually get higher recoveries through those programs. I think taking a look at what has happened to credit scores because of the foreclosure crisis, to help people become eligible for refinances, of the kind you hjave mentioned, is another piece. And I think I have been encouraging the administration and others to bring together the credit rating agencies and the lenders to work on that. I think in the servicing standards, we have to establish national servicing standards and lenders have to be encouraged to give a loan loss mitigation a more serious try before they move to foreclosure, and, essentially, they become worried about time.

And I think that there are tricky issues with Fannie and Freddie in mandating them to refinance because it is not always the case that a refinance in that case will result in a higher recoveries. And the government in the current period has an obligation to mitigate their losses. But I think it is possible if you do that in the right circumstances, to encourage Fannie and Freddie to do refinancings or principal write-downs. It might actually increase recoveries.

Ms. Wasserman Schultz. And you would agree that it is certainly better than what the Republicans have proposed which is to just get rid of all the foreclosure mitigation programs and do nothing else and leave people twisting in the wind?

Ms. Wartell. I understand the frustration because many of these programs have not worked as nearly as well as we would have liked. And I think we do not understand something about the behavioral models of the financial institutions as to why what seems to be economically rational have not been steps that they have chosen to take, but I think that approach, which is to throw the baby out with the bath water, if you will, is only to, sort of, finding the bottom faster in very painful ways.

Ms. Wasserman Schultz. But what disturbs me is that the only thing that our Republican colleagues under their leadership has proposed is, what are colleague, Mr. Hanserling has said, that is that best foreclosure mitigation program is a job. And that is certainly a let them eat-cake approach and one that is not going to help solve the problem over the long term, would you agree?

Ms. Wartell. I would. I think that voiding avoidable foreclosures is not only in the best interest of maintaining the larger economy, it is also in the lender's best interest and we have to find a way to see where those interests align.

Ms. Wasserman Schultz. Thank you, very much. I yield back.

Mr. Garrett. The gentle lady yields back. Yield to the gentle lady for introduction.

Ms. Kaptur. I think the gentlemen. I just want to encourage the Chairman and the Ranking Member to keep focus on deep probes about the future of the U.S. housing finance system is essential to our system of capital formation. And I just wanted to put on the record the book, the "Mystery of Capital," by Hernando Desoto, where he talks about the importance of our property valuation system. And housing is so tied to that now, as essential to our form of capital accumulation and savings in this country; we need to be talking at that level in this Congress about where we are headed with this market. And so I thank the Chairman for this hearing today and look forward to working with him and Mr. Van Hollen in the future to do a better job for the American people.

Mr. Garrett. And I thank the lady for that. And I will yield myself the remaining five minutes of this hearing to just run down a couple of questions. So we heard from at the very outset from Ms. Lucas with regard to the necessity or the encouragement for it to go into consistency and a more transparent and a fair value rating as far as accounting. We heard from Ms. Wartell to say that as far as for all the debts has already incurred we should not go back and change it for what is on the books already and use that system, correct? And basically going forward, though, I also thought

I heard you say that you would not suggest that we go and adopt what the CBO is recommending with regard to changing the evaluation or the accounting methodology for the entities; is that correct?

Ms. Wartell. As to the GOCs I think, in their current form in conservatorship, that is correct.

Mr. Garrett. And with the FHA?

Ms. Wartell. With the FHA, I believe that they should be accounted for under Credit Reform, they need to improve their models, which I think they are working on, but I think the fair value accounting should certainly not be done only for FHA, and I think probably needs to be refined significantly before we are adopted government wide.

Mr. Garrett. My understanding, though, is you would not, then, take into the risk factor that which CBO would be placing in their accounting, is that correct?

Ms. Wartell. This method of pricing that risk factor is not one that I think is appropriate at this time.

Mr. Garrett. Right. And that is where we disagree because I think most people would understand that you have various risk factors, both in the pricing of housing going forward over the next 30 years, you are nodding your head that that is a risk. And also, there certainly is interest rate risk, and the first, of course, is credit risk. Somehow or other that has to be taken and accounted for because system rehab right now, correct me, if not, shows actually that there is a profit over FHA, correct?

Ms. Wartell. For FHA.

Mr. Garrett. And I think the gentleman from Indiana made somewhat of a flippant sort of comment saying, well, if that is making a profit, then I guess we should insure the entire marketplace. Is there any reason why his flippant comment is not correct that we should not insure the entire market if we are making a profit there or expand it significantly?

Ms. Wartell. Yes. And I think the reason is because of the wisdom of the policy makers in this committee and in this Congress who will not simply because it is a revenue source to make decisions that are bad for the housing market.

Mr. Garrett. Okay. At the very beginning of our hearing today, Mr. Van Hollen started off by saying, "Well, no one wants to go back to a system that guarantees either explicitly or implicitly," and then he continued on. But after the last hour, I realized yes, there are. The gentleman to the right wants to do that, and the gentleman over to the left also want to do that. They do want to go back to a system that has, at least at some level, in their proposals, at least some level where the government will explicitly guarantee it. Well, Mr. Pollock, you said something that sparked an idea in my head. You said we have already tried that to the extent to say that with the GSEs to say that, well, there was private equity in there and it got wiped out. Is that not really just on a different variation of what these various proposals are here today: it will wipe these things all out, but you still, at the end of the day, the federal government, that means you and everybody in this room, backs it up?

Mr. Pollock. Yes, I agree with that, Mr. Chairman.

Mr. Garrett. Okay. So there is any version that comes out either side of the aisle, as well-intentioned as they mean, where at the end of the day, that federal government has to step in to provide the liquidity into the marketplace, means that there is a guarantee by federal government. Ms. Lucas, is that too simple of an understanding of that if there is a guarantee at the end of the day?

Ms. Lucas. No. I think it is absolutely right. And I think the challenge in the design of moving to a new system is to make the need for that as unlikely as possible.

Mr. Garrett. And was that not also partly the design for the GSEs that we have right now, the design was to make it unlikely and not possible because that was the system we already just went through, correct?

Ms. Lucas. That has right.

Mr. Garrett. All right.

Ms. Lucas. It was a system where they tried to put private capital there, but the requirements for the capital were quite thin.

Mr. Garrett. Right. And another point, the gentleman from South Carolina made an interesting point with regard to what this is costing us, and he came up with a number of $140 billion a year in a sense that there is a cost to the fact that we have so much GSE debt out there, agency debt out there, this is impacting upon the price of treasuries. Mr. Pollock, you said that, correct?

Mr. Pollock. That is right, Mr. Chairman.

Mr. Garrett. Does anyone disagree with that assessment that the fact that we have so much agency debt out there that that effects in some way shape or form price of treasuries? No one disagrees?

Ms. Wartell. I have not had a chance to look at the study Alex refers to so I would be happy to comment for the record.

Mr. Garrett. If that is true, though, and the gentleman says that that is costing even $100 billion, should not that be reflected somewhere in our accounting for federal government besides the price risking Ms. Lucas is talking about, should that not be reflected some place in our budget?

Ms. Wartell. If that is the case, it is, because that is the price the Treasury is paying for the debt. So I think it is reflected in our budget.

Mr. Garrett. So it is priced in the fact that it was costing us more money to borrow all the money that we are stuck having to borrower all the time, is what you are saying?

Mr. Pollock. But we do not understand it was an effect of what we are doing with agency debt.

Mr. Garrett. But you said it is built into the higher cost of borrowing.

Ms. Wartell. I am not prepared at this point to comment on the study because I have not seen it. But Treasury pays the price the Treasury pays for a debt. It fluctuates based on a variety of factors consistently, and to what extent the size of the agency debt is a part of that, I cannot comment today.

Mr. Garrett. And last point on this, and not to open up a whole thing, but as the gentle lady from California made the accusations that we do not care on the Republican side of the aisle, and that sort of thing about people twisting in the wind and I do not think anyone on our side wants that to occur.

Ms. Wartell. Of course.

Mr. Garrett. But is it not possible that we can try to get to the same end game? To try to make sure that there is sufficient housing in the country, to try to deal with the situation that the gentle lady is trying to deal with here, people in difficult situations that, instead of financing debt, which is what our system does right now, correct, we could finance equity and we could finance equity through a whole host of other programs and would still get to the same end game of trying to deal with the housing situation. Is that not an alternative to this situation?

Ms. Wartell. I am not sure what you mean by financing equity. If you mean provide direct grants in the form of down payment assistance, you can, although the leverage there means that the additional amount of assistance is significantly more expensive for the taxpayers.

Mr. Garrett. And it is all on the books as well.

Ms. Wartell. I would argue that the goal of Credit Reform and all of our policies here is to put it on the books. And if I might, sir, the one difference between the past in any of the proposals in the future, is that the guarantee for the GSEs in the past was implicit, not explicit and they never paid for it. And what we are all proposing for any system in the future is that it be paid for so that that would be on the books.

Mr. Garrett. And I think we will close to understand that someone is going to pay for it no matter what. You are right. But I do thank you very much, to the panel, and the gentle lady's comment with regard to further hearings on this or other discussions, formal or otherwise, I think would be a great thing because they are to technical and it is so very important. So, thank you for that. We will look forward to doing that. Thanks to the panel.

The record, it will be open for the next 30 days and if there are additional questions, they can submit it to the panel. And to that end, I will take the profit of the chair and to submit one question to Ms. Wartell right now to elicit your comments on that last question with regard to the studies. That would be fantastic. Thank you again to the panel and to all the members who stayed with us. Thanks. The meeting is adjourned.

[Whereupon, at 12:40 p.m., the Committee was adjourned.]