Fannie, Freddie Overhaul Will Translate Into Higher Mortgage Rates

3:25 pm ET

Apr 3, 2014

By

NICK TIMIRAOS

Mortgage rates could rise by as much as 1.5 percentage points for homeowners with weaker credit or smaller down payments under various legislative proposals to overhaul**Fannie Mae**FNMA +5.58% and **Freddie Mac**FMCC +5.84%, according to a study prepared for an industry group.

Bloomberg News

The study, by **Kent Colton** and **Michael Carliner** of the Harvard Joint Center for Housing Studies, was produced for the **Leading Builders of America**, a trade group representing large U.S. home builders. The study found that earlier estimates of mortgage-rate increases from an overhaul of the mortgage-finance giants**understate the potential impact to average American borrowers**.

“We wanted to make sure people k

“We wanted to make sure people knew that there’s a range of potential costs. It’s not just the ‘best-case scenario’ cost,” said **Ken Gear**, executive director of the trade group. Mr. Colton is a former chief executive of the **National Association of Home Builders**.

The Colton-Carliner paper examined the potential cost to borrowers under the housing-finance overhaul envisioned in a bill introduced last year by Sens. **Bob Corker** (R., Tenn.) and **Mark Warner** (D., Va.). They estimate that rates could rise between 0.25 and 1.5 percentage points as a result of higher capital requirements and other fees imposed by the overhaul.

The worst-case estimates are most likely to hit borrowers with credit scores of between 650 and 750 and down payments of around 5% to 15%. (Under a system devised by Fair Isaac Corp., credit scores run on a scale from 300 to 850.) The paper worked off of earlier models from **Andrew Davidson**, an industry consultant, and **Mark Zandi**, chief economist of **Moody’s Analytics**.

Mortgage rates are likely to rise under any plan to overhaul Fannie and Freddie because most proposals call for the firms or any successors to hold more capital than the mortgage-finance giants did. There’s little dispute that Fannie and Freddie failed because they held too little capital for the risks they were taking.

Fannie and Freddie don’t make loans; instead, they buy them from banks and other lenders. They package those loans into securities that are sold to other investors, and they provide guarantees to make investors whole when loans default. That

has created deep, liquid markets for mortgages that help lower borrowing costs for American households.

The mechanics of how any new system is designed and how much capital is required will play a significant role in determining just how much more borrowers could pay for mortgages.

The leaders of the **Senate Banking Committee**, Sens. **Tim Johnson** (D., S.D.) and**Mike Crapo** (R., Idaho) last month introduced their own bill, which was modeled off of the Corker-Warner proposal, and the committee will meet April 29 to consider amendments and to vote.

Mr. Gear said he supported the approach taken by the Johnson-Crapo bill, but said he hoped to see "more clarity" around the impact of any overhaul on borrowing costs. "You'd hate to go through all this reform and realize, this is going to add three percentage points to mortgage rates," he said.

A separate study published last month from Mr. Zandi and **Cristian DeRitis** of Moody's Analytics estimated that the Johnson-Crapo bill would **increase rates by around 0.4 percentage point** for borrowers with a 750 credit score and a 20% down payment, bringing the today's mortgage rate of around 4.5% for a 30-year, fixed-rate loan to around 4.9%. On a median priced home, the increase translates into a monthly payment that is around $40 higher.

Such an increase would have a "measurable but very modest impact on the housing market," wrote Messrs. Zandi and DeRitis. They estimate that the higher financing costs could reduce home sales by around 250,000 units and housing starts by 100,000 units over three years.

At a 5.5% interest rate, the monthly payment on the median priced home is around $100 higher than current levels, while a 6% rate would boost payments by $150 per month. Messrs. Colton and Carliner estimated that could knock out between 6% and 9% of qualified borrowers, reducing housing starts by as much as 155,000 per year.

Meanwhile, analysts at **Barclays Capital** last month estimated that the Johnson-Crapo bill, meanwhile, could boost rates by around 0.2 percentage points for the best borrowers. Those with good credit but small down payments could see rates rise by 0.4 percentage points. For borrowers with lower credit scores, rates could rise by 0.8 percentage points.

UPDATE: Some industry economists say the paper exaggerates the effect that any housing-finance overhaul would have on mortgage rates. Already, Fannie and Freddie use risk-based pricing that charges higher fees to riskier borrowers, which are often passed along in the form of higher rates. By failing to account for those higher costs that already exist, "the paper significantly overstates the impact" of any overhaul on mortgage rates for weaker borrowers, said **Laurie Goodman**, director of the Housing Finance Policy Center at the **Urban Institute**.

Moreover, estimates about the potential impact on home sales could be too high because many borrowers with weaker credit aren't currently qualifying for mortgages given tighter underwriting standards. "It doesn't take into account that those borrowers aren't in the market anyway right now," said **David Crowe**, chief economist of the**National Association of Home Builders**. By removing uncertainty from the mortgage market, any housing-finance overhaul

could actually expand credit access, even if riskier borrowers are paying higher rates, he said.