



The Future of Fannie Mae and Freddie Mac

It's clear that some type of reform is in the works. But what will this reform look like?

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Fannie Mae and Freddie Mac are two of the most unique institutions in the United States. Each is a government-sponsored entity, a private organization that receives large amounts of federal funding. This public money is then used to help American consumers buy homes by facilitating the lending of money for [mortgages](#).

[See [21 Things We're Learning to Live Without.](#)]

For decades, Fannie and Freddie, as they've come to be known, did exactly that. They facilitated lending to people of all income brackets, including the middle and working class. They did this by ensuring that these mortgages would be paid. Republicans were wary of both, as they opposed federal money going to a private corporation. But for many Americans, Fannie and Freddie made homeownership possible.

In 2004, however, Freddie and Fannie made the fateful decision of getting involved in the subprime loan market. They began insuring subprime mortgages issued to borrowers that would not have qualified for a traditional mortgage. When the subprime bubble popped, Fannie and Freddie lost billions—some estimate losses could total \$360 billion. The government was left to pick up the tab.

Fannie and Freddie quickly became pariahs. In 2008, the Treasury Department took control of the companies. Soon after, their stocks were removed from the New York Stock Exchange. Fannie and Freddie came to represent the excess of the housing market, even though private banks had created the subprime mortgage market.

Right now, it's not clear whether Fannie and Freddie will continue to exist. Congress has held numerous hearing this year to plot a course for the companies. Republicans have repeatedly attacked them. Most Democrats now agree that significant changes have to be made to ensure that another subprime-like crisis doesn't occur again.

It's even become a campaign issue. Republican presidential hopefuls are attacking frontrunner Newt Gingrich for accepting \$1.6 million in consulting fees.

It's clear that some type of reform is in the works. But what will this reform look like? How will it impact consumers? Will Freddie and Fannie exist in a year?

[See [Do We Need Fannie and Freddie?](#)]

An uncertain future. Some kind of government insurance system for mortgages is likely to survive the Freddie/Fannie disaster. But it's unclear what this system would look like. For now, Freddie and Fannie are operating as they have in the past, but are much more selective about the mortgages they'll back.

Late last week, Sen. Johnny Isakson, a Republican from Georgia, introduced the Mortgage Finance Act of 2011. This legislation would create the Mortgage Finance Agency, which would provide insurance to mortgages that meet specific criteria. The bill would eliminate Fannie and Freddie.

"This legislation is a detailed road map to change the unsustainable course we're on in which the American taxpayers have been bailing out the mortgage industry to the tune of hundreds of billions of dollars," Isakson said last week. My bill will shut down Fannie Mae and Freddie Mac through an orderly transition, and it will repay the taxpayers."

Few believe the legislation will pass. But it does acknowledge the new reality of the U.S. housing market: Right now, it is very difficult to get a home loan.

[See [How Buying a Home Is Likely to Change.](#)]

Responsible lending, disciplined savings. The reason housing prices remain stagnant throughout most of the country is that people simply cannot afford the down payments necessary to qualify for a mortgage.

During the subprime housing crisis, lenders were offering mortgages that required little or no money down and with very low interest rates. The catch was that rate would change a few years down the line, adjusting higher (hence the term adjustable-rate mortgage). When the rates changed, many people couldn't afford their homes and were unable to pay their mortgage. This kicked off the sequence of events that caused the housing bubble to burst and the U.S. economy to slip into recession.

The bad news is that homeownership might be out of reach for some. The good news, however, is that long-term renting is becoming a more accepted practice.

[See [9 Smart Ways to Come Up With Down-Payment Cash.](#)]

If you're determined to buy a home, the key is saving. Sizable down payments are now needed to qualify for a mortgage, and the government will only insure borrowers with a good credit history.

Housing prices remain depressed. So while a down payment is necessary, it's not impossible to cobble together. "[H]omeownership is a self-imposed savings plan. Not everyone should own a home, but from a financial perspective, people who are planning to stay in a property over the long term can benefit from buying," Ken Johnson, editor of the *Journal of Housing Research* at Florida International University said at a recent conference.

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Corrected on 12/15/11: A previous version of this story misspelled the name of U.S. Senator Johnny Isakson, and erroneously used the word "lenders" in place of "borrowers."

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