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## Market Ponders Life If GSEs Fall Under Government Control

By Erika Morphy

Federal Reserve Chairman Ben Bernanke gave the capital markets and Wall Street much to think over in a speech he delivered on Friday. The good news is that he doesn't expect inflation to spiral out of control; on the contrary he expects the current price run-up to moderate over the next two years. Perhaps more interestingly, he also gave the audience at Jackson Hole, WY a view into the proactive strategy that is apparently driving much of the administration's actions, such as its role in the bailout of Bear Stearns earlier this year.

Indeed, he cites Bear Stearns as an experience that "has led me to believe one of the best ways to protect the financial system against future systemic shocks, including the possible failure of a major counterparty, is by strengthening the financial infrastructure, including both the 'hardware' and the 'software' components. The Federal Reserve, in collaboration with the private sector and other regulators, is intensively engaged in such efforts."

His proposed strategy for reducing systematic risk in the financial system hinges on strengthening the financial infrastructure and increasing the system-wide focus on financial regulation and supervision. For instance, "one might imagine also conducting formal stress tests, not at the firm level as occurs now, but for a range of firms and markets simultaneously. Doing so might reveal important interactions that are missed by stress tests at the level of the individual firm," Bernanke said. No doubt, given the pressure the financial markets are currently under, there are many that would welcome stronger government hand in the economy – despite the clear danger of a moral hazard.

But where does that leave Fannie Mae and Freddie Mac: two unique institutions whose finances grow increasingly shakier as they are forced to hold loans on their books for want of a market to resell them -- but still provide the bulk of financing in the multifamily space? Growing talk of a government bailout – which, it must be said, has been denied by Treasury Department executives -- has driven their stocks to record lows. It is doubtful stockholders would ever support the GSEs again if they are left with worthless shares; but would these GSEs under government control continue to support the multifamily space?

Bernanke's comments essentially acknowledged what the government is already doing to a certain extent, **Doug Huberman, CEO of RVM Associates, a Pasadena, CA based real estate development firm, tells GlobeSt.com. "I think it will be an assistance to the market, giving people assurance rather than having to guess. Many times the uncertainty can be as damaging as what is actually happening."**

GSE stockholders, at least of the common shares, would certainly lose money, but he doubts that a government bailout would lead to a pullback – or at least a large one – of financial support for multifamily lending. **"Without liquidity even good projects go wanting – and that is the primary danger to the economy right now, far more than inflation or short-term unemployment," Huberman says.**

Private sector lenders will not make loans unless they know they can be repackaged and

repurchased, he says. Not that Fannie and Freddie have a market where they can sell the loans they have bought – which indeed is driving their current crisis. **"They are losing billions because they are unable to sell," Huberman says. For the GSEs to continue buying loans, they will simply have to continue to stockpile on their balance sheet until the capital markets do return. For that they will need to continue to borrow -- or receive funding from the government."**

Leaving aside the matter of the shareholders, an explicit guarantee from the federal government would be a good development for mortgage rates as well, Dave Dessner, SVP with New York City-based Guardhill Financial, tells GlobeSt.com. "If inflation, in fact, continues to moderate, the bond market should rally," he says, explaining his reasoning. "There would be a bigger move into T-bills. That, plus lower spreads for Fannie and Freddie, would inject more confidence into the credit markets."

Fannie Mae's and Freddie Mac's importance to the multifamily market was illustrated in the recently released Mortgage Bankers Association's Quarterly Survey of Commercial/Multifamily Mortgage Bankers Originations. It found that in Q2, originations were 63% lower than during the same period last year. The year-over-year decrease was seen across most property types and investor groups – except for Fannie Mae and Freddie Mac, which reached record-high originations. "That was one of the stronger quarters they have had on record," Jamie Woodwell, MBA's VP of commercial/multifamily real estate research, tells GlobeSt.com. What many people forget, he says, is that multifamily loans have been performing extremely well. "The delinquency rates for these loans are extremely low and even lower than they were a year ago. Given the credit crunch and pull back of lending from other sources, the GSEs have been able to make sure the loans they are taking on are underwriting the way they want and priced the way they want."

The GSEs, for their part, insist they are remaining in the market. Fannie Mae, for example, is preparing to introduce new products to its DUS community, according to comments executives made during its recent earnings call. For instance, it will be introducing a Streamlined Rate Lock execution product that allows lenders to lock the interest rate on borrowers' loans at any point during the underwriting process, thus providing more delegation to lenders. Currently Fannie Mae offers several rate lock products but they all are encumbered with a prescribed underwriting process. Fannie Mae also plans to roll out a product that will provide financing across the entire property lifecycle, from construction to permanent financing, along with a rate lock capability. Whether it will have the financial wherewithal to follow through on execution remains to be seen.