Federal Government Doesn't Expect Fannie Mae Will Ever Again Turn a Profit

November 15, 2011 - The federal government took control over both Fannie Mae and Freddie Mac in late 2008. Both companies were placed in conservatorship, with the federal government as their sole stockholder. At the time, the official statement from the Treasury Department stated that the takeover of the two companies shouldn't cost taxpayers any money and should, over the long run, actually return a profit. But so far that hasn't been the case. And now the Federal Housing Finance Agency (FHFA), the conservator for both Fannie Mae and Freddie Mac, has made an announcement that makes it very clear that Fannie is not ever expected to recover. It is a startling admission and brings up many questions about the health of US housing markets and the government's role in providing private financing.

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The admission from FHFA came in the form of court briefing documents filed in an attempt to halt a lawsuit. The state employee pension fund in Ohio is suing Fannie, claiming that the company overstated profits and understate risks associated with its investments in home mortgages. The fund is claiming that these misstatements cost it and other investors billions of dollars.

FHFA had filed court documents seeking to halt the suit on the grounds that even if the plaintiffs were to prevail in court, they â€œalmost certainly will never be able to collect even a single dollar of any final judgment.â€• The reasons given in their brief were that, a) the federal government is legally the first in line to receive any repayment, even if there is a judgment against company and, b) because the fate of the company is very uncertain. The documents covered scenarios that included the possibility of a receivership due to bankruptcy.

But even bankrupt companies can reorganize and survive. Again, FHFA documents make it clear that any idea that Fannie Mae would eventually emerge as a strong, independent company is probably mere fantasy, stating that the

chance of that happening â€œis so exquisitely remote that it cannot begin to justify the continuing expenditure of litigation costs in this matter.â€•

Fannie Mae has been the largest single recipient of federal bailout funds since the housing crisis began. The company has received at least $168 Billion since 2008 and officially still owes nearly $105 Billion of that money to the government. Furthermore, they just informed congress that they will need another $7.9 Billion bailout in order to continue operations.

Since 2008, the company has had a negative net worth at the end of every quarter. Yet, little has been done to strip the company of its toxic assets. And between Fannie Mae and Freddie Mac, these two companies provided backing for nearly 90% of all mortgages written nationwide last year. They are an integral part of the housing market, but little is being done to either strengthen the companies, or to wind them down. Instead, FHFA seems to believe that the solution to the issue is simply to pump additional money into them every quarter. As of this moment, there is no apparent end in sight to this recurring cycle.

Stripping bad assets could take place in a prepackaged bankruptcy, but even that wouldn't guarantee survival of Fannie without a corresponding tightening of lending standards. Publically, it does appear that lending standards have tightened since 2008. But not enough. FHA loans can still be approved for buyers with as little as a 3.5% down payment. And Fannie Mae continues to offer rebates of up to 3.5% on some of the properties it owns. This means that it is still possible to purchase a home with nothing down; one of the primary issues that led to the housing crisis in the first place.

There are also issues associated with providing backing for loan modifications and insuring banks against losses on loans; something that both Fannie and Freddie do. If the federal government insists on using these companies in this way for already questionable loans, they will quickly run into new financial trouble even after emerging from bankruptcy.

Politically speaking, it is probably unthinkable that the federal government would shut down either Fannie or Freddie. Such a move - especially if it was sudden - would collapse real estate markets nationwide. But speaking practically, something needs to be done with both companies. As long as the companies continue to operate as they do currently, taxpayers are in the untenable position of subsidizing virtually every residential real estate transaction that takes place across the country.

As for the law suit, the judge in the case denied FHFA's motion. The suit is moving ahead.

byJim Malmberg
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