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Leaders weigh in on Fannie Mae, Freddie Mac failure, fed bailout

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While the federal takeover of embattled mortgage giants Fannie Mae and Freddie Mac was expected, the long-term impact of the colossal bailout won't materialize for years. It likely won't be until long after this real estate and mortgage crisis ends.

However, the short-term ramifications already are taking shape. Taxpayers and shareholders are early

losers, and real estate-dependent markets — including Phoenix, Las Vegas, and cities in California and Florida — likely will benefit the most.

ONLINE: For more comments from business leaders on the Fannie Mae and Freddie Mac bailouts, go to phoenix.bizjournals.com.

The Washington-based Federal National Mortgage Association and McLean, Va.-based Federal Home Loan Mortgage Corp. purchase or guarantee

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most of the nation's home mortgages. Both are major players in the Phoenix market, which has been slammed in the past three quarters by record foreclosures and plummeting home values — some sinking more than 40 percent.

In 2007, Freddie Mac invested \$18.7 billion in the Grand Canyon State, enabling 10,807 residents to purchase their first homes and helping 655 families avoid foreclosure.

The takeover by the U.S. Treasury Department, the Federal Reserve and the Federal Housing Finance Agency was intended to stabilize the housing and financial markets and boost confidence among consumers facing inflationary pressures, high commodity prices, rising unemployment and other economic challenges.

The markets responded quickly, as mortgage interest rates flattened early last week. Bankrate Inc. reported 30-year fixed mortgages averaged 5.88 percent on Sept. 9, down from 6.26 percent a week earlier.

However, financial institutions including Wells Fargo & Co. announced more charge-offs in the third quarter from investments related to the struggling companies.

The San Francisco bank paid \$490 million for investments in the two troubled mortgage giants. Those preferred stock investments now are worth 5 percent to 10 percent of that original price tag.

More charge-offs are expected to follow, on top of the \$470 billion in losses this year recorded by U.S. financial firms.

When details of the deal were announced last week, the government vowed to inject up to \$100 billion each into Fannie Mae and Freddie Mac to prevent insolvency and said it would start buying mortgage-backed securities from both companies.

That has many in the business community and some small-government proponents fuming.

Because the federal plan affects so many industries in the Valley, *Phoenix Business Journal* reporters queried nearly a dozen local executives about the move.

Here are some of their responses:

Will the action by the Fed to take over Fannie Mae and Freddie Mac have any immediate effect on the Phoenix housing market?



Zeitzer

BETH JO ZEITZER: "Locally, we will start feeling the effect of the Fed's dramatic takeover of Freddie and Fannie in the coming weeks, as money will become more available for mortgage lenders. Additionally, interest rates ... could come down as low as

5.25 percent. Recently, the lack of capital and tight lending standards have made it difficult for some borrowers to obtain home loans. Injecting more money into the system, in addition to lower rates, will allow more buyers to get into the game on a more traditional basis."

CROCKER LIU: "I think the immediate effect is

WEIGHING IN

The *Phoenix Business Journal* asked the following Valley business leaders what they think about the recent federal takeover of Fannie Mae and Freddie Mac:

- Greg Burger, president, RL Brown Housing Reports
- Beth Jo Zeitzer, president, ROI Properties
- John Vatisstas, chairman and CEO, Russ Lyon/Sotheby's International Realty
- Byron Schlomach, economist, Goldwater Institute
- Crocker Liu, real estate and finance professor, Arizona State University
- Nicholas Michael Ingle, capital markets director, Hendricks & Partners
- Dean Bloxom, president, I-Mortgage
- Mark Dioguardi, founding partner, Dioguardi Flynn LLP
- Paul Johnson, president, Old World Communities
- John Foltz, president, Realty Executives
- John Fioramonti, senior managing director, Meyers Builder Advisors
- Anthony Sanders, finance professor, Arizona State University

that funding doesn't dry up... that the mortgage market remains 'liquid' so borrowers can borrow money to buy houses."

JOHN FOLTZ: "This could and should reduce mortgage interest rates in the short term. That would tend to make houses more affordable and reduce some of the pressure on buyers. So it will help — but it is not yet known, of course, how much it will help."

JOHN VATISTAS: "No."

Why do you think the takeover happened?



Vatisstas

VATISTAS: "Fannie Mae and Freddie Mac were making extraordinary profits for a great many years. Unfortunately, they were also artificially manipulating their earnings and committing fraud. They are simply getting their just due. They only care about their

stock options. Between Wall Street (which is the main culprit of this housing crisis), Fannie and Freddie, they've managed to turn the American Dream into the American Nightmare."

BYRON SCHLOMACH: "Rather than bailing them out, the two should have been disbanded and the assets sold off altogether. These kinds of bailouts feed cycles rather than flatten them out."

FOLTZ: "With the government now calling the shots, there are agendas other than just making money, like supporting the recovery of the housing market, which is part of the underpinnings of the economy."

NICHOLAS MICHAEL INGLE: "The recent increases in lending spreads signified that foreign investors were losing confidence in the quality of our guaranteed mortgage assets. If the situation were allowed to further deteriorate, the fallout could have further

diminished the availability of financing and caused even greater hardship in the residential transaction market. Despite the enormous potential costs of the government interceding in the operations of the agencies, the conservatorship does serve to protect the welfare and net worth of many Americans."

LIU: "What the bailout won't do is help the local Arizona market for those houses that have already been foreclosed on or those that are on the verge of default. One thing folks don't seem to remember is that it's all about supply and demand."



Liu

What is the upside of the takeover?

PAUL JOHNSON: "A failure of these two institutions would have devastating economic consequences. The upside will be lower interest rates, a stabilization of the housing market and an assurance to Wall Street that the twin towers of home finance are protected."

JOHN FIORAMONTI: "The only upside that I see is the stabilization of the capital mortgage markets."

ZEITZER: "The upside will be building consumer confidence to bring buyers to the table, or expanding their homeownership acquisition strategies. We also believe this move could bring investors back to the market. Investors have been waiting on the sidelines for a bottom, and the take over of Freddie and Fannie may just be the trigger they need."

DEAN BLOXOM: "The action gave a nice drop in interest rates, so that is a positive for any market. There is some great upside in that the international markets will feel safer in participating in our markets, keeping liquidity up."



Bloxom

What is the downside?

FIORAMONTI: "This bailout will only encourage other industries to look to the government for bailouts — airline, automobile, etc."



Dioguardi

MARK DIOGUARDI: "The main downside is the probable cost to the taxpayers. The net effect on banks is unclear, since we do not know if they own more Fannie Mae/Freddie Mac bonds (which are helped by this action) or Fannie Mae/Freddie Mac stock (which is hurt by

the takeover). Is it an upside or downside that the biggest beneficiaries of the bailout will be the governments of China and Japan, which are the two largest owners of Fannie Mae and Freddie Mac bonds?"

JOHNSON: "The downside will come to the equity investors in Fannie Mae and Freddie Mac, as well as to the taxpayers, who will have to foot this bill."

INGLE: "There exists the downside that diluted shareholder equity lends a certain 'moral hazard' to the government's bailout of organizations that clearly mismanaged risk. Further, recent escalations in the retail costs to provide residential mortgages

seemed to act counter to the mission Fannie Mae and Freddie Mac are entrusted with — namely, to make housing finance



Ingle

affordable to Americans."

FOLTZ: "The downside is that, historically, the government has a hard time competing with private enterprise in efficiency and effective management. The 'bureaucracy effect' over a period of time could have some negative impact."

Do you think the federal decision was the right one, the only choice?

ZEITZER: "Had the Fed not stepped in, I believe we would have seen a crash and burn the likes of which haven't been seen since the Great Depression."

GREG BURGER: "I doubt there was really any choice in the matter. Economic catastrophe would have been the alternative."

ANTHONY SANDERS: "The federal government had already declared that they would provide capital to Fannie Mae and Freddie Mac on an 'on the need' basis. What changed? Warren Buffett, a leading investor in the market, scared



Sanders already jittery investors to the core. So, raising capital in the private market became a problem. But the federal government could have simply put up the money. There is no need for any bailout at this time. In addition, they could have ordered further reduction in the retained portfolio, a restructuring of top officer salaries and bonuses, etc. Why this drastic approach?"

What do you feel the consequences will be?

FIORAMONTI: "In the long run, I think we will see Fannie and Freddie operating like any other government bureaucracy — bloated, over budget, under efficient, over regulated and noncompetitive."

BLOXOM: "At the end of the day, this may help 2009 be a year of recovery instead of more turmoil."



Burger

BURGER: "The feds will, in effect, bail out the private investors with the taxpayers footing the bill, but we will end up with a more cost-effective way of securitizing mortgage debt. I believe it was appropriate medicine for the toxic mortgage products offered at the time and is a positive step toward the recovery process."

JOHNSON: "These two entities need to be privatized after being broken into smaller pieces. By creating sub entities, a failure of one or two would not have devastating consequences on the U.S. financial system. Today, they are too large. Our economy could not withstand their failure."

VATISTAS: "If the government can use their leverage and cut the fat out of both entities, with the backing of the U.S. government, there should be cheaper borrowing costs. Will that happen? Probably not. There will, however, be less greed, less fraud, less waste and much more regulation. I think we are in for at least a two-year run before they figure out what to do with it. It will all depend on how long the housing crisis takes to work itself out."



Johnson