



## Testimony

Before the House Financial Services Committee, Subcommittee on Housing and Insurance,  
Hearing on “Homeownership and the Role of the Secondary Mortgage Market”

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Chairman Flood, Ranking Member Cleaver, and Members of the Committee, thank you for the opportunity to testify at today’s hearing. My name is Norbert Michel and I am Vice President and Director for the Center for Monetary and Financial Alternatives at the Cato Institute. The views I express in this testimony are my own and should not be construed as representing any official position of the Cato Institute.

Given the spectacular 2008 failure of the federal government’s housing finance policies, it is unfathomable that anyone would contemplate perpetuating the government-sponsored enterprises (GSEs) at the heart of the pre-2008 system. Yet, since 2008, multiple administrations and Congresses have done precisely that. Many have even tried to expand that system by replacing implicit government guarantees with explicit guarantees.<sup>1</sup>

Advocates of these proposals unabashedly want borrowers to pay fees to secure investors’ returns, all in the name of incentivizing home ownership. But actively bolstering home purchases is a dangerous policy goal, one that has already backfired and cost Americans dearly. More importantly, government guarantees are not necessary for financial markets to properly function, and they impede and distort optimal decision making and outcomes.

Congress should never have created government-sponsored enterprises to bolster the secondary mortgage market or the broader housing finance market, and it should not make home ownership an explicit policy goal rather than fixing policies that erect barriers to broader economic success. It is long past the time to pare back the federal government’s role in housing finance. Obviously, investors love federal guarantees for their investments. But financial markets do a better job of pricing risk and assets, as well as helping people allocate resources, without such guarantees. Ultimately, government guarantees for financial securities ensure that investors pay too little attention to the true underlying risk in those securities, and there is no better example of the consequences of such policies than the 2008 crisis.

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<sup>1</sup> See, for example, Norbert Michel, “[The Bipartisan Housing Finance Reform Act of 2018 Does Not Protect Taxpayers](#),” Testimony before the Committee on Financial Services U.S. House of Representatives December 21, 2018.

Expanding these kinds of guarantees will continue to produce excessive leverage, overbuilding in the housing sector, and home prices that are higher than they would be otherwise. All the groups that benefit from such a system—mortgage bankers, commercial bankers, relators, and investors, to name a few—will continue to fight for, at the very least, maintaining existing guarantees. For the betterment of all their constituents, members of Congress should stand firm against this rent-seeking.

### **Shortages, Affordability, and Ownership**

For nearly a century, increasing homeownership rates has been a focus of federal policy. This push to increase ownership has been the source of many problems, and Congress should correct this policy mistake. Policymakers do not have objective reasons for tilting the market in favor of buying versus renting, and it is harmful to saddle low-income individuals (or those with uneven earning power) with a large amount of long-term fixed debt. Policymakers should allow people to decide for themselves whether and when they wish to buy or rent.

Likewise, it is a mistake for policymakers to push homeownership as an investment strategy, especially as a highly leveraged investment. The long-term, wealth-building effect of homeownership is often less than that of renting and investing in a diversified set of assets.<sup>2</sup> Whether buying or renting and investing is a better strategy for long-term net worth is dependent on many factors, such as the price-to-rent ratio (the ratio of a home's selling price to its renting price), future house price appreciation, future rent inflation, future market returns, and mortgage rates.

In general, renting is almost always a better decision for short-term residency (under 10 years) due to the lack of closing costs or high-interest payments that are only associated with buying. It is true that a longtime homeowner might enjoy higher net worth relative to renting and investing, especially if house price appreciation and rental inflation are both high relative to market returns. If, however, market returns are high and house price appreciation and rental inflation are low, renting and investing would likely lead to higher net worth, *even* for long-term residencies.

### *Questioning the So-Called Housing Crisis*

In the aftermath of the COVID-19 pandemic, the United States experienced a much higher rate of inflation than at any time during the prior few decades. Like the prices of many goods and services, the cost of housing rose rapidly, with the median home price increasing almost \$100,000. Unsurprisingly, many potential homebuyers are still shocked and upset.<sup>3</sup> Politicians, commentators, and various trade groups have been sounding the alarm that this price increase is the latest evidence of a housing affordability crisis, one marked by shortages and market failures.<sup>4</sup>

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<sup>2</sup> Norbert Michel and Jerome Famularo, “[Homeownership and Wealth: Why Policymakers Should Stop Subsidizing Risk](#),” Cato at Liberty, November 6, 2025.

<sup>3</sup> Norbert Michel and Jerome Famularo, “[Questioning the Housing Crisis: Recap and Wrap-Up](#),” Cato at Liberty, January 13, 2025.

<sup>4</sup> The supposed increase in the age for first-time home buyers is also frequently cited as evidence of a crisis. Norbert Michel and Jerome Famularo, “[First-time Homebuyer Crisis: Fact or Fiction?](#),” Cato at Liberty, September 3, 2025.

But a great deal of evidence suggests that the United States is not facing a housing crisis or a broad shortage of homes. For instance:

- House prices aside and contrary to the conventional wisdom, Americans at all income levels have done increasingly well over the past several decades. Outside of the COVID-19 inflation spike, most consumer goods and services have become more affordable over time, and interest rates steadily declined, suggesting that Americans could afford to spend more on housing than they did in the 1960s and 1970s.
- Americans experienced solid income growth over the past five decades. From 1967 to 2023, the share of households earning (in real terms) less than \$35,000 fell from 31 percent to 21 percent, and the share earning between \$35,000 and \$100,000 fell from more than 53 percent to 38 percent. During the same period, the share of households earning more than \$100,000 essentially tripled, from 14 percent to 41 percent. According to the Bureau of Labor Statistics, the share of Americans making at or below the minimum wage declined from 1.1 percent in 2012 to 0.3 percent in 2022.
- These statistics are consistent with Americans purchasing bigger homes with more amenities, and that's exactly what they've been doing for decades. They've been buying larger houses and living in them with fewer people. Holding both the average home size and household size constant, homes have become slightly more affordable, with the share of household income spent on new homes displaying a slightly decreasing trend since 1975.<sup>5</sup>
- Work hours needed to afford rent remained stable from 2007 to 2019. Additionally, both rent and food expenditures as a percentage of income varied little until the pandemic. Thus, the recent spike in prices and rents is anomalous. It has certainly been harmful to many people, but it was not indicative of a long-term trend. To the extent that nominal incomes continue to rise, the real effects from this spike will continue to dissipate.
- Even though the US population increased by 130 million people during the past five decades, the homeownership rate remained stable outside of the 2008 crisis. The homeownership rate rose even after prices started spiking in 2019.
- A basic estimate of housing availability shows that housing construction has broadly kept up with population growth. For instance, between 2000 and 2021, the average building units permitted per 100-unit change in population was approximately 93 housing units. This relationship is not necessarily optimal, and more housing could certainly make some people better off, but this relationship makes it extremely difficult to support the idea of a widespread housing shortage or market failure.
- Americans have consistently been choosing to rent and buy in more densely populated areas. These choices reveal that people have a strong preference for living in certain

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<sup>5</sup> In 2024 Senator Elizabeth Warren (D-MA) asked her X followers, "You ever wonder how your grandparents bought a home for seven raspberries, but you can't afford a one-bedroom apartment?" However, data suggests that between 1963 and 2023 the average house in the United States never cost less than three million raspberries. Norbert Michel and Jerome Famularo, "[Senator Warren Is Way Off on Raspberries—and Americans' Living Standards](#)," Cato at Liberty, August 16, 2024.

areas—for a variety of reasons—and are willing and able to pay to live in those places. Many people have moved from higher-cost areas to lower-cost areas, but most of these moves were from densely populated areas to other densely populated areas. These patterns tend to contribute to higher nominal house prices partly because new land cannot be produced in the same way that other goods can.

- While home prices spiked during the COVID-19 pandemic, average new home prices peaked in 2022. By October 2025 they were about \$70,000 lower than the peak. Additionally, the number of weeks of wages needed to cover the full price of a home is at its lowest point since 2020, and it's now lower than during much of the 2010s. In October 2007, it took 324 weeks of wages to afford the full price of a home. In October 2025, that figure was 312. In fact, across several categories, median housing cost as a share of income has been flat or decreasing since the pandemic.<sup>6</sup>

These facts do not provide evidence that all Americans are just fine, or that more people wouldn't benefit from lower rents, lower housing prices, and higher income. More importantly, these facts do not suggest that there isn't already excessive federal involvement in mortgage markets, or too much regulation at the federal or state and local level. Indeed, most people would be doing even better without so much regulation and federal involvement in housing markets. It should be pared back and even eliminated.

The point *is*, however, that policymakers should not be scared into perpetuating (or expanding) parts of the housing finance system for the sake of solving a broad housing crisis, shortage, or market failure. That kind of problem does not exist in the United States, and policymakers should focus on fixing harmful policies that make it difficult for people to participate in an expanding and open economy, to move up the income ladder, and to improve their cost of living. (For instance, Congress could remove the government guarantees that the GSEs provide in the secondary market, thus boosting demand and pushing nominal home prices higher, everything else held constant.)

Proponents of the relentless housing crisis story often uncritically cite estimates of a housing “shortage” ranging from one million to twenty million homes.<sup>7</sup> That range itself is enough to question the usefulness of those estimates. But these kinds of estimates are usually highly subjective measures of the state of the housing market, and slight changes to the inputs can alter the “shortage” estimates to a surplus.<sup>8</sup> Moreover, the mere fact that many people would prefer to pay less for housing does not constitute an economic shortage.

It is likely true, for instance, that many younger people would no longer live with their parents if housing were less expensive, just as many of them would likely buy Porsches or Lamborghinis if they were less expensive. It is false, though, to refer to either of these situations as an economic shortage. On the other hand, if prospective home buyers were to enter the market, decide that they were willing and able to pay the prices at which people desired to sell, and *then*

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<sup>6</sup> Norbert Michel, “[Scapegoating Investors Won't Lower Home Prices](#),” The Dispatch, February 2, 2026.

<sup>7</sup> Julie Weil, “[Why nobody really knows the scale of the U.S. housing crisis](#),” The Washington Post, February 4, 2026.

<sup>8</sup> Norbert Michel and Jerome Famularo, “[Questioning the Shortage Narrative: How Small Assumptions Rewrite the Housing Story](#),” Cato at Liberty, September 29, 2025.

find that they could literally not buy a home at that price, the market could be properly characterized as having a shortage of homes. In general, this situation does not exist in the United States, or even in most of local housing markets within the many geographic segments of the United States.

Of course, state and local government officials should relax zoning restrictions and other regulations to make it easier and less costly for people to live, and to allow builders and developers to more easily meet demand. At the same time, federal officials should eliminate the federal policies that artificially boost demand, thus pushing nominal housing prices higher. Eliminating the GSEs is one example of something that Congress could do to eliminate these kinds of harmful housing policies. The GSEs were created when financial markets were less sophisticated than they are currently, and there is no reason to perpetuate a government guaranteed duopoly (or monopoly) under the purely speculative notion that no investors would be willing to invest in mortgages, or mortgage-backed securities (MBS).<sup>9</sup>

### **Brief History of the GSEs**

The typical history of Fannie Mae describes a government agency created in 1938 to purchase government-insured mortgages, thus providing lenders with much needed cash. This oversimplification masks the true nature of Fannie Mae and how it became the GSE that currently sits in conservatorship, along with its twin Freddie Mac. In fact, the National Housing Act of 1934 provided for the creation of “national mortgage associations.” These associations, envisioned as private companies, were supposed to spur housing construction by purchasing government-insured mortgages, thus boosting jobs.<sup>10</sup> The 1934 act was amended in 1938 to accelerate this process because no associations had yet been formed – even with government insurance, it seems investors did not want to invest in severely depressed real estate.

While the 1938 amendments did not explicitly authorize the creation of a *federal government* agency to purchase mortgages, the Reconstruction Finance Corporation (RFC) chartered the National Mortgage Association of Washington. It then promptly changed the association’s name to the Federal National Mortgage Association, giving birth to Fannie Mae (using the letters FNMA).

Although the 1934 act and its amendments prohibited Fannie Mae from making direct loans, Fannie effectively became a direct lender to mortgage companies and builders through “pre-commitments” to buy loans that did not yet exist. This practice underscores the inherent conflicts that have always existed in Fannie Mae’s operations. First, Fannie was effectively in competition with savings and loan associations (S&Ls), the main source of mortgage funding in that era. S&Ls did not need funding from Fannie Mae, and Fannie’s operations only made life

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<sup>9</sup> Moreover, evidence suggests that federal guarantees alone cannot explain the high liquidity of GSE mortgage-backed securities in financial markets. James Vickery and Joshua Wright, “[TBA Trading and Liquidity in the Agency MBS Market](#),” Federal Reserve Bank of New York, Economic Policy Review, Volume 19, Number 1, May 2013.

<sup>10</sup> Richard W. Bartke, “Fannie Mae and the Secondary Mortgage Market,” *Northwestern University Law Review*, Vol. 66, No. 1 (March–April 1971), p. 17. Also see Norbert J. Michel and John L. Ligon, “[Fannie and Freddie: What Record of Success?](#)” Heritage Foundation *Backgrounder* No. 2854, November 7, 2013; Norbert Michel and John Ligon, “[GSE Reform: The Economic Effects of Eliminating a Government Guarantee in Housing Finance](#),” Heritage Foundation *Backgrounder* No. 2877, February 7, 2014; and, John Ligon and Norbert Michel, “[Why Is Federal Housing Policy Fixated on 30-Year Fixed-Rate Mortgages?](#)” Heritage Foundation *Backgrounder* No. 2917, June 18, 2014.

easier for S&L's competitors, companies known as mortgage bankers. These mortgage companies welcomed Fannie Mae funding because they did not have access to people's deposits to fund new loans.

There was also, as there still is, a basic financial contradiction between operating profitably and supporting federal housing priorities. Lending money to build homes is profitable only when the loans are paid back on schedule, a fact that does not change when taxpayers guarantee loan repayments. Nor does this fact change simply because politicians want to increase the number of homes built or make homes more affordable. Consequently, policymakers eventually must choose which motive—profit or politics—is more important. These issues have existed since Fannie Mae began operating, and they spurred multiple attempts to privatize the agency.

In 1954, for instance, the Eisenhower Administration tried by rechartering Fannie Mae as a “government corporation” with “mixed” ownership. The President’s advisers felt that the government was too deeply involved in housing policy to privatize Fannie immediately, so they tried to set it on a course toward privatization.<sup>11</sup> Taxpayer money was used to buy stock in Fannie, but the intent of the 1954 Charter Act to privatize was clear. Eisenhower told Congress, “The Federal government should be enabled to purchase the initial stock of the reorganized association, but private capital funds supplied by users of the facility should be built up to speed retirement of the government’s investment.”<sup>12</sup>

By this time, the federal government and the financial industry were fully invested in the “growing availability of mortgage funds on more liberal credit terms.”<sup>13</sup> Although Fannie remained a bit player in the housing market through World War II, by 1953 it had a \$2.5 billion portfolio (when total federal expenditures were \$72 billion). Although only about 8 percent of U.S. Department of Veterans Affairs loans in 1953 were made with no downpayment, that figure shot up to more than 28 percent in 1954, with a similar rise in maturities. The 1954 Act also permitted the Federal Housing Administration (FHA) to insure larger loans with smaller downpayments and longer terms.

There was a sharp increase in home building between 1953 and 1954, but the expansion occurred “wholly in the government-assisted sector of the market,” where total starts during the year 1954 “increased by about 133,000 units over 1953; starts under the FHA and V.A. programs increased by nearly 175,000 units, while conventionally financed starts declined.”<sup>14</sup> As one account explains:

The sharp increase in home building in 1953 and 1954 was apparently not associated with major changes in basic demand for housing, demand responded readily to the growing availability of mortgage funds on more liberal credit terms. And easier mortgage terms in turn reflected the decline in other demands for funds and an extraordinary response of the

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<sup>11</sup>James R. Hagerty, *The Fateful History of Fannie Mae: New Deal Birth to Mortgage Crisis Fall* (Charleston, SC: The History Press, 2012), p. 30.

<sup>12</sup>Hagerty, *The Fateful History of Fannie Mae: New Deal Birth to Mortgage Crisis Fall*, p. 32.

<sup>13</sup> Leo Grebler, “[The Housing Expansion of 1953-1954: A Classic Response to Easy Credit](#),” in *Housing Issues in Economic Stabilization Policy*, edited by Leo Grebler, NBER, 1960.

<sup>14</sup> Grebler, “[The Housing Expansion of 1953-1954: A Classic Response to Easy Credit](#),” pg. 16.

financial system to the policy of credit ease initiated in May 1953.<sup>15</sup>

While the Housing Act of 1954 allowed Fannie to raise private capital, the law contained vague language on privatization and failed to establish any kind of deadline or outline for a process. Unsurprisingly, Fannie was never privatized.

In 1958, President Eisenhower signed an “anti-slump” bill that gave \$550 million to Fannie Mae to buy mortgages for urban renewal projects, as well as another \$300 million for direct Veterans Affairs housing loans.<sup>16</sup> It included “up to \$1.85 billion” in government funds for urban renewal, explicitly to help build “another 100,000 houses, create 500,000 new jobs...and lay a solid floor under those sagging industries that lean heavily on home construction.”<sup>17</sup> Getting the government completely out of Fannie’s operations proved impossible, but it came closer to reality in 1968.

The Johnson Administration, desperate to remove debt from the federal budget, used the 1968 Housing and Urban Development Act to move Fannie’s debt off the federal books. The act split Fannie up into a federally chartered “private” company, Fannie Mae, and Ginnie Mae, an entity fully owned by the government. Ginnie Mae was given Fannie’s former job of purchasing only government-insured mortgages. The new Fannie was allowed to purchase mortgages that were *not* insured by federal agencies.

This change did not privatize Fannie and, if anything, it cemented the GSE model. The newly reorganized company still had a \$2.25 billion line of credit with the U.S. Treasury, an exemption from state and local income taxes, and an exemption from Securities and Exchange Commission registration. The law also allowed the U.S. president to fire its directors and let federally regulated banks buy unlimited amounts of Fannie’s debt, giving it equal regulatory treatment with U.S. Treasury securities. Bond markets, faced with the obvious truth that Fannie was not really a private company, referred to its debt as “agency” debt, with a subtle difference from Treasury debt. Starting in 1968, the regulator charged with protecting the taxpayers from this risk was the Department of Housing and Urban Development (HUD). In 1979, HUD prevented Fannie Mae from adopting a less risky financing strategy so that HUD could increase “the flow of mortgage funds into older urban areas.”<sup>18</sup>

Congress first addressed Fannie’s lack of capital in the 1968 HUD Act by preventing the GSEs from taking on debt of more than 15 times its capital *unless* the HUD secretary approved a higher leverage ratio. However, by the end of 1969 the HUD secretary had already lessened the requirement twice—first to 20 times, then to 25 times.<sup>19</sup> This trend continued, and by 1981 the provision was essentially meaningless with the ratio hovering around 50 times its capital for the

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<sup>15</sup> Grebler, “[The Housing Expansion of 1953-1954: A Classic Response to Easy Credit](#),” pg. 21.

<sup>16</sup> [Business: Cheaper Mortgages](#), Time Magazine, April 7, 1958.

<sup>17</sup> [Business: Cheaper Mortgages](#), Time Magazine, April 7, 1958. For more on urban renewal see Richard M. Flanagan, “[The Housing Act of 1954: The Sea Change in National Urban Policy](#),” Urban Affairs Review, Volume 33, Issue 2, 1997; and Nathaniel S. Keith, *Politics and the Housing Crisis Since 1930*, Universe Books, NY:NY, 1973.

<sup>18</sup> Congressional Budget Office, “Controlling the Risks of Government-Sponsored Enterprises,” April 1991, p. 179.

<sup>19</sup> Richard Bartke, “Fannie Mae and the Secondary Mortgage Market,” *Northwestern Law Review*, Vol. 66, No. 1 (March–April 1971), p. 51.

rest of the 1980s.<sup>20</sup>

In 1970, President Nixon signed the Emergency Home Finance Act of 1970, a law that (among other things) created the Federal Home Loan Mortgage Corporation, commonly referred to as Freddie Mac, a whole new GSE designed just for the Federal Home Loan Banks.<sup>21</sup> By the end of the 1970s, the question of the GSEs' public purpose versus private profit was as cloudy as ever, and the vested interest groups had successfully walled off the GSEs from privatization. At this point, the federal government no longer had any ownership stake in Fannie Mae, and its common stock was publicly traded. Like Fannie Mae, Freddie Mac was not supposed to be a federal agency that continued forever. Freddie became a publicly traded company in 1989.

Although both companies had private shareholders, as of 1989 both Fannie and Freddie were government-sponsored enterprises. As GSEs, they both benefited from a line of credit with the U.S. Treasury, an exemption from filing financial statements with the Securities and Exchange Commission, and an exemption from state and local income taxes.<sup>22</sup> Freddie issued its first mortgage-backed security (MBS) in 1971, but Fannie did not issue its first MBS until 1981. Thus, the system that officially came apart in 2008, with Fannie and Freddie both purchasing non-federally insured private mortgages and issuing MBSs, did not really begin until the 1980s.

Throughout the 1980s, Freddie Mac focused on issuing MBSs from the loans it purchased, while Fannie Mae decided both to issue MBSs and to build its own portfolio of MBSs and mortgages. This decision allowed Freddie to pass much of its risk onto outside investors, while Fannie remained directly exposed to a large amount of interest rate risk (the risk that interest rates would rise and adversely impact the value of the company's investments).<sup>23</sup> This choice to hold mortgages caused Fannie Mae to become insolvent when interest rates rose dramatically throughout the late 1970s and early 1980s.

The U.S. General Accounting Office reported that Fannie suffered "cumulative net losses of over \$350 million in 1981, 1982, 1984, and 1985."<sup>24</sup> Although insolvent, Fannie was saved through "regulator forbearance" (i.e., the problem was ignored) and a special tax provision that allowed it to forgo paying federal income taxes for up to 10 years. Freddie Mac avoided financial trouble during this time mainly because of its decision against building up its own mortgage loan

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<sup>20</sup>These figures are computed as ratios of the total debt to equity using balance sheet data reported in Federal Housing Finance Agency, *Report to Congress 2012*, June 13, 2013, p. 81, [http://www.fhfa.gov/webfiles/25320/FHFA2012\\_AnnualReport.pdf](http://www.fhfa.gov/webfiles/25320/FHFA2012_AnnualReport.pdf). While large financial institutions such as commercial banks would have been required to maintain a capital ratio of more than 5 percent throughout the 1990s, Fannie and Freddie's capital ratios were approximately 1 percent in 1990.

<sup>21</sup>For a full account of these agencies' history, see Federal Housing Finance Agency, Office of Inspector General, "History of the Government Sponsored Enterprises," <http://fhfaig.gov/LearnMore/History>, and "Glossary of Terms," <http://fhfaig.gov/LearnMore/Glossary>.

<sup>22</sup>The bond market certainly recognized the special nature of the GSEs. It has always called Fannie's and Freddie's bonds "agency debt," a name that reflected the (correct) belief that the federal government would save the companies if they were in financial trouble. Incidentally, in 1968, the House Committee on Banking and Currency made this federal "backstop authority" clear and said that it would "tend to enhance the corporation's credit standing." Lloyd Musolf, *Uncle Sam's Private, Profitseeking Corporations*, Lexington Books, Lexington: MA, 1983, p.34.

<sup>23</sup>Longer-term assets, such as the mortgages that Fannie was holding, are very sensitive to interest rate changes.

<sup>24</sup>U.S. General Accounting Office, *Government-Sponsored Enterprises: The Government's Exposure to Risks*, August 1990, p. 9.

portfolio—a decision that was appropriate given the GSEs' intended purpose.

In a 2005 letter to *The Wall Street Journal*, Thomas Bomar, the first chief executive officer (CEO) of Freddie Mac, explained, “Accumulating a large mortgage portfolio would have been inconsistent with the intent for which Freddie Mac was created.”<sup>25</sup> Regardless, at the end of 1981, Fannie held just under \$60 billion in its mortgage portfolio, and Freddie held just over \$5 billion. By the end of 1990, Fannie held a portfolio of nearly \$114 billion, while Freddie’s mortgage portfolio was just over \$21 billion.<sup>26</sup>

To fuel this growth, the GSEs used their special status to borrow money at below-market interest rates—a fact that increased the GSEs’ profitability and the taxpayers’ risk. For example, shareholders enjoyed profits when GSEs could borrow short-term funds at 4 percent to fund long-term loans that charged customers 8 percent. However, if those long-term rates quickly increased to, for instance, 12 percent, Fannie would no longer be able to borrow so cheaply.

In the 1980s, the Reagan Administration explored the privatization of several government enterprises, including Fannie and Freddie. In 1988, Reagan’s Commission on Privatization called for an end to “all Federal benefits and backing for Fannie and Freddie, leaving them fully ‘privatized’ after a transition period.”<sup>27</sup> The Omnibus Budget Reconciliation Act of 1990 added even more political pressure. The 1990 Act required the Congressional Budget Office to prepare a study on the GSEs that included “an analysis of the financial risks each GSE assumes,...the financial exposure of the Federal Government posed by GSEs, and the effects of GSE activities on Treasury borrowing.”<sup>28</sup> Fannie Mae countered with its own privatization study, conducted by the investment bank Shearson Lehman Brothers.

Fannie’s 1989 study, which argued that privatization was a bad idea, was overseen by Jim Johnson, a Lehman employee.<sup>29</sup> In 1990, Johnson was hired by Fannie Mae CEO David Maxwell to fend off those who wanted to privatize the GSEs, and he quickly became Fannie’s CEO in waiting. One of Johnson’s first ventures as CEO was to launch Fannie’s Open Doors to Affordable Housing, a program that committed \$10 billion to financing low-income borrowers. Johnson then opened “partnership offices” throughout the U.S. to promote Fannie’s programs. Soon, politicians as ideologically opposed as Ted Kennedy and Newt Gingrich were participating in photo ops at their local Fannie Mae offices.<sup>30</sup> According to one former Fannie Mae executive,

The partnership offices gave us an enormous advantage when Congress was debating further regulations. We were able to call on our leaders and upon all our partners in the cities where we had these offices and say you have to weigh in. Write to Congress.<sup>31</sup>

In fact, Fannie did much more than just lobby for their cause. *The New York Times*

<sup>25</sup>Thomas R. Bomar, “[Freddie Mac Was Meant to Succeed, Die Young](#),” *The Wall Street Journal*, June 13, 2005.

<sup>26</sup>Congressional Budget Office, “[Controlling the Risks of Government-Sponsored Enterprises](#),” April 1991, pp. 130–165.

<sup>27</sup>Hagerty, *The Fateful History of Fannie Mae*, p. 71.

<sup>28</sup>Congressional Budget Office, “Controlling the Risks of Government-Sponsored Enterprises,” p. iii.

<sup>29</sup>Gretchen Morgenson and Joshua Rosner, *Reckless Endangerment: How Outsized Ambition, Greed, and Corruption Led to Economic Armageddon* (New York: Times Books, 2011), p. 17.

<sup>30</sup>Morgenson and Rosner, *Reckless Endangerment*, pp. 62–63.

<sup>31</sup>Morgenson and Rosner, *Reckless Endangerment*, p. 64. Eventually, HUD officially acknowledged that Fannie had misused the partnership offices as primarily lobbying offices. See Adam Selene, “HUD Review: Fannie Mae Offices Misused,” Associated Press, October 17, 2005, <http://www.freerepublic.com/focus/news/1504347/posts>.

reported that Fannie (and Freddie) literally wrote much of the bill that became the Federal Housing Enterprises Financial Safety and Soundness Act of 1992.<sup>32</sup>

In another effort to protect taxpayers, the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (1992 GSE Act) placed formal capital requirements on the GSEs. The act required the GSEs to hold capital worth between 0.45 percent and 2.5 percent of their assets.<sup>33</sup> The law also created the Office of Federal Housing Enterprise Oversight (OFHEO) within HUD as an independent regulator for the GSEs, but it directed HUD to require—rather than just suggest—the GSEs to meet certain affordable housing goals.<sup>34</sup>

The 1992 GSE Act called for the HUD secretary to establish three broad affordable housing goals for each of the GSEs. The new requirements went into effect in 1995, and the figures were updated several times. For 2001–2003, the goals were:

- **Low-income and moderate-income goal.** At least 50 percent of the dwelling units financed by each GSE's mortgage purchases should be for families with incomes no greater than area median income (AMI), defined as median income for the metropolitan area or nonmetropolitan county. The corresponding goal was 42 percent for 1997–2000.
- **Special affordable goal.** At least 20 percent of the dwelling units financed by each GSE's mortgage purchases should be for very low-income families (those with incomes no greater than 60 percent of AMI) or for low-income families (incomes up to 80 percent of AMI) in low-income areas. The corresponding goal was 14 percent for 1997–2000.
- **Underserved areas goal.** At least 31 percent of the dwelling units financed by each GSE's mortgage purchases should be for units located in underserved areas. Research by HUD and others had demonstrated that low-income and high-minority census tracts had high mortgage denial rates and low mortgage origination rates, and this formed the basis for HUD's definition of underserved areas. The corresponding goal was 24 percent for 1997–2000.<sup>35</sup>

The story of how the 1992 law was shaped is a tale of a deliberate strategy by the GSEs (led by Fannie Mae) to use affordable housing goals as a weapon to secure its special government privileges. This strategy undoubtedly allowed it to avoid stricter capital standards and full privatization for decades. As the 21st century approached, this strategy became even more important because Fannie's critics doubled their efforts to completely privatize the GSEs.

In 1994, Fannie announced its Trillion Dollar Commitment, a program that earmarked \$1 trillion for affordable housing between 1994 and 2000.<sup>36</sup> Gretchen Morgenson and Joshua Rosner claim that Johnson was “the original, if not anonymous, architect of what became the disastrous

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<sup>32</sup>Stephen Labaton, “[Power of the Mortgage Twins](#),” *The New York Times*, November 12, 1991.

<sup>33</sup>The act also included a risk-based capital requirement that required the GSEs to hold sufficient capital to withstand a severe “shock” to the economy. See Joseph E. Stiglitz, Jonathan M. Orszag, and Peter R. Orszag, “[Implications of the New Fannie Mae and Freddie Mac Risk-Based Capital Standard](#),” *Fannie Mae Papers*, March 2002.

<sup>34</sup>Prior to the 1992 GSE Act, HUD only “encouraged” the GSEs to devote a fixed percentage of its mortgages to certain lower-income/underserved groups.

<sup>35</sup>U.S. Department of Housing and Urban Development, “[HUD's Affordable Lending Goals for Fannie Mae and Freddie Mac](#),” *Issue Brief* No. V, January 2001. For the current affordable housing goals, see Federal Housing Finance Agency, “2026–2028 Enterprise Housing Goals,” [Final Rule](#), Federal Register, Vol. 90, No. 244, Tuesday, December 23, 2025.

<sup>36</sup>See [Allie Mae](#), “History of Fannie Mae.”

homeownership strategy promulgated by William Jefferson Clinton in 1994.”<sup>37</sup> Clinton’s National Partners in Homeownership, a private–public cooperative, set a goal of raising the U.S. homeownership rate from 64 percent to 70 percent by 2000.

With this onslaught of cooperation, taxpayer subsidies, and grant money, the U.S. homeownership rate increased from 64 percent in 1994 to 69 percent in 2004. However, as the financial crisis hit and more than 4 million people lost their homes, the rate fell back to 65 percent—only 1 percentage point higher than in 1968. From 1990 to 2003, Fannie and Freddie went from holding 5 percent of the nation’s mortgages (\$136 billion) to more than 20 percent (\$1.6 trillion).<sup>38</sup> In 2008, the companies were deemed insolvent and put into government conservatorship.

### Details on GSE Conservatorship

On September 6, 2008, the Federal Housing Finance Agency (FHFA) placed the GSEs under conservatorship rather than receivership. In accordance with its broad conservator powers, the FHFA secured two \$100 billion credit lines (one for each company) from the Treasury to bail the GSEs out of trouble. As part of the Preferred Stock Purchase Agreements (PSPAs), each GSE issued a million shares of a new class of senior preferred stock to the Treasury (with an initial valuation of \$1,000 per share) in exchange for its line of credit.<sup>39</sup>

The PSPAs specified various other terms and conditions of the bailout, and the initial agreement contained several taxpayer protections, including the following four items.

- Absent Treasury approval, dividend payments on classes of stock other than the specially created senior preferred stock were suspended until the GSEs repurchase the preferred stock from the Treasury.
- Treasury holds the right (through warrants) to purchase up to 79.9 percent of the GSEs’ common stock. The warrants do not require the Treasury to make this purchase.
- A “liquidation preference” specifies that any funds derived from either new capital infusions or the liquidation of assets must first be used to compensate taxpayers for the bailout, and the GSEs cannot emerge from conservatorship without paying this liquidation preference in full. The liquidation preference was initially set at \$1,000 per share (\$1 billion for each GSE’s senior preferred stock). It was also designed to increase as the GSEs drew on their lines of credit and if the GSEs did not pay (to the Treasury) the periodic commitment fees due on the senior preferred stock. In the event the GSEs are dissolved, the liquidation preference takes priority over liabilities due to other investors or creditors.
- The GSEs were required to pay quarterly dividends on the Treasury’s senior preferred stock. The initial PSPAs set these dividends equal to 10 percent (annualized) of the value of the liquidation preference if paid in cash. Dividend payments were also set to increase if the Treasury extended additional credit. Notably, dividend payments on the senior

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<sup>37</sup>Morgenson and Rosner, *Reckless Endangerment*, p. 11.

<sup>38</sup>Hagerty, *The Fateful History of Fannie Mae*, p. 144.

<sup>39</sup> This section borrows heavily from Norbert Michel, “[The GSE Experiment Has Failed—Congress Should End It](#),” Cato Briefing Paper No. 180, October 14, 2024.

preferred stock do not diminish the value of the liquidation preference—the dividend payments functioned as interest on a loan, and the balance of the liquidation preference reflects the unpaid principal.

Between 2008 and 2012, the companies struggled and had difficulty meeting their financial obligations under the PSPAs. While the FHFA could have placed the GSEs into receivership, the FHFA and the Treasury chose instead to amend the PSPAs three times. Each rendition effectively forced the taxpayers to bail out the GSEs again. Thus, in total, the GSEs were bailed out four times, as follows.

- In September 2008, the Treasury bailed out both GSEs, promising to provide each with up to \$100 billion in credit. In return, the companies each gave the Treasury one million shares of senior preferred stock, worth \$1 billion each. In just the first three quarters of the conservatorship, Fannie Mae exhausted one-third of its Treasury credit commitment, and Freddie Mac exhausted more than half of its commitment.
- In May 2009, with losses rapidly piling up, the Treasury doubled its prior commitment, promising to provide each GSE with up to \$200 billion in credit.
- In December 2009, with the companies still struggling, the Treasury changed its commitment formula, allowing it to provide more than \$200 billion in credit. The GSEs drew on these lines of credit in 2010, 2011, and 2012. The \$200 billion caps adjusted upwards by the amount of the draws throughout those three years, less any positive net worth of the GSEs at the end of 2012. The GSEs' poor financial performance between 2009 and 2012 resulted in the commitment expanding from \$400 billion in 2009 to \$445.5 billion by the end of 2012.
- At the end of 2011, the GSEs' combined liquidation preference was more than \$187 billion. Moreover, the required 10 percent senior preferred stock dividends of nearly \$19 billion per year exceeded the net income ever earned by the GSEs in a single year. It had become obvious that the GSEs might be unable to meet their obligations to the Treasury—from December 2008 through December 2011, the GSEs had borrowed \$36 billion from the Treasury to pay the dividends they owed the Treasury. So, in August 2012, the Treasury changed the dividend formula to prevent the GSEs from further drawing on the Treasury commitment just to pay the dividends. Specifically, the Treasury amended the agreement in August 2012 so that beginning in August 2013, the Treasury would take ("sweep") any GSE profits to satisfy the quarterly dividend payments.

In addition to these bailouts, the Treasury and Federal Reserve purchased more than \$3 trillion in MBSs and GSE bonds, staving off further losses. From September 2008 through December 2009, the Treasury purchased more than \$220 billion of GSE MBSs. The Fed purchased \$134.5 billion of GSE bonds and more than \$1.1 trillion of GSE MBSs from December 2008 through March 2010 and an additional \$2.2 trillion in MBSs from October 2011 through June 2019. As of September 2024, the Fed still holds \$2.3 trillion in MBSs on its balance sheet.

While the fourth (2012) amendment was controversial, the GSEs would not have survived without these federal bailouts. As FHFA Director Edward DeMarco explained after this 2012

amendment, “The continued payment of a fixed dividend could have called into question the adequacy of the financial commitment contained in the PSPAs.” Demarco also reaffirmed the FHFA’s “commitment to move forward with the components of the Strategic Plan for the Conservatorships of Fannie Mae and Freddie Mac,” a plan that included (among other items) “gradually contracting their operations.”

Nonetheless, the companies are larger today than they were in 2012. Aside from normal growth, in 2021, the FHFA removed restrictions on the GSE’s ability to acquire single-family mortgages, certain loans with higher risk characteristics (including second homes and investment properties), and multifamily loans. As a result, Fannie Mae’s mortgage loans (net of allowances) increased from \$2.9 trillion in 2012 to \$4.1 trillion in 2023. Freddie Mac’s net mortgage loans increased from \$1.7 trillion in 2012 to \$3 trillion in 2023. Despite their growth, both GSEs have negative capital balances and remain in conservatorship.

The FHFA suspended the GSEs’ capital requirements for the duration of the conservatorships because the GSEs had no capital, but these must be reinstated upon release. Although the FHFA allowed the GSEs to retain profits and build additional equity in 2019, their capital balances remain negative, as they have been since 2008. Importantly, the current negative capital balances of both GSEs would result in classification as “critically undercapitalized” if the FHFA reinstated their capital standards. Under the Housing and Economic Recovery Act of 2008 (HERA), the FHFA director has the discretionary power to place the GSEs into receivership and liquidate their assets if they are classified as critically undercapitalized.

As of 2019, the GSEs needed approximately \$200 billion to avoid being classified as critically undercapitalized under the FHFA’s proposed capital rules. However, since 2021, the GSEs have improved their capital position by approximately \$100 billion, suggesting that they may need to raise \$100 billion to exit conservatorship and meet the minimum capital requirements. Yet this (still quite large) figure ignores the additional amount that would be needed to pay the nearly \$200 billion liquidation preference on the senior preferred stock.

Any write-down of this liquidation preference would be another bailout, but supporters argue that such a write-down is justified because the GSEs paid back more in dividends than the amount they borrowed. This argument, however, focuses strictly on cash-flow accounting. It ignores the principal component of the original debt agreement, the ongoing risks borne by taxpayers, and the opportunity costs associated with the cash infusions. In other words, any such amendment would deprive taxpayers of proper compensation for the risks they undertook during the past 16 years for bailing out the GSEs.

### **What Congress Should Do**

Robust homeownership existed in the United States long before the government became heavily involved in the housing market, and a competitive private market is not possible if the current government-guaranteed duopoly is allowed to continue. Liquidation of the GSEs—rather than recapitalization and release—is the most prudent way to create this competitive marketplace.

In the absence of the GSEs, fully private companies with no US Treasury credit lines or other special funding advantages can purchase and securitize mortgages. Rather than invest in the

GSEs, investors can provide capital to new companies that do not have either implicit or explicit taxpayer backing, thus reducing taxpayer risk, ending the economic distortions caused by the government domination of the market, and gradually improving housing affordability.

Prior to the 2008 financial crisis, the federal government controlled a dominant share of the US housing finance system, and that share has expanded. As of 2023, Fannie and Freddie (both of which remain in government conservatorship) had a combined guaranty book of business of \$7.6 trillion, representing approximately 47 percent of the nation's outstanding mortgage debt. From 2009 to 2023, Fannie and Freddie's annual share of the total MBS issued averaged 70 percent. Including Ginnie Mae securities (those backed by FHA mortgages), the federal share of the MBS market averaged 93 percent per year. Moreover, from 2008 to 2023, the Federal Reserve went from holding zero MBS to more than \$2 trillion (combined Fannie, Freddie, and Ginnie MBS).<sup>40</sup>

Even though the US homeownership rate has changed little since the 1960s, volatility of home prices and home construction in the United States were among the highest in the industrialized world from 1998 to 2009. Overall, the evidence suggests that the expansive federal role has expanded *mortgage* ownership but has done little to expand homeownership. At the very least, federal housing finance policies have magnified economic instability by inducing higher home prices. Federal involvement expanded after the most recent financial crisis, for instance, and home prices rose to 43 percent more than where they peaked before their 2007 crash.

Inducing demand in supply-constrained markets can only serve to put upward pressure on prices, and housing markets are no exception. Nonetheless, inducing demand is precisely what federal policies have done for decades by making it easier to obtain home mortgages. Congress can start to reverse these trends by winding down the GSEs and reducing federal involvement in housing finance.

One option for to start moving away from the GSE system is for the FHFA to remove Fannie and Freddie from conservatorship and place them into receivership (with the goal of liquidation). To place the GSEs into receivership, the FHFA must first reinstate the capital requirements and classify the GSEs as critically undercapitalized. Once the GSEs enter receivership, the FHFA director may begin the liquidation process and transfer GSE assets and liabilities into newly chartered limited-life regulated entities (LLREs). Each GSE charter would then be immediately transferred to the LLREs, and each LLRE would assume the powers and attributes of the GSE being liquidated.

The FHFA would then have a maximum of five years to wind down all the affairs of the LLREs. Once the FHFA sells at least 80 percent of the LLRE's capital stock to third parties, the LLRE terminates automatically. The FHFA must then divest any remaining capital stock of the former LLRE within one year. To finally get rid of the GSEs, Congress, not the FHFA, would then need to revoke the GSEs' charters to prevent them from being rereleased into the marketplace. Importantly, without this type of wind down, any plan must fully compensate taxpayers for prior

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<sup>40</sup> Norbert Michel, “[The GSE Experiment Has Failed—Congress Should End It](#),” Cato Briefing Paper No. 180, October 14, 2024.

bailouts and ongoing credit risk by repaying the liquidation preference in full before resuming dividends to private shareholders.

Another option would be for Congress to simply revoke Fannie's and Freddie's charters, with the FHFA establishing capital standards for any financial entity that wishes to purchase mortgages and sell mortgage-backed securities. This could be the best way to allow for more competition in housing finance markets. Under this scenario, as well as any other scenario for dealing with the GSEs (including the status quo), the federal government will still be responsible for backing a portion of outstanding GSE debts. These obligations, therefore, are no reason to avoid ending the failed GSE experiment.

## Conclusion

Relying on investor guarantees, security standardization, government mandates, risk allocation by dictate, and strict regulation doubles down on the failed government policies that created the 2008 crash. Unencumbered, markets function so that risk is allocated to those best able to handle it, and so that firms avoid restricting access to credit-worthy borrowers. Policymakers that push against these forces because their constituents do not want to hold risk and because they want to expand credit beyond existing levels, are directly responsible for (at the very least) the housing finance market turmoil realized during 2008 and the costs of the associated bailouts.

History has proven that financial markets will provide funds for housing without the federal government socializing investors' losses. If policymakers want to make housing more affordable, they should push for an open, vibrant, competitive market, without heavy regulation and government guarantees. Such a market would make consumers better off, even though it may fail to bolster the standing of all the groups that benefit financially from the current system. An explicit federal guarantee of mortgage-backed securities will continue to make housing less affordable and markets unstable, as did the so-called implicit guarantees of the pre-2008 system.