Kucinich Investigates Treasury's Coverage of Unlimited Housing Finance Company Losses

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By Corbett B. Daly - Analysis

WASHINGTON (Reuters) - At a hearing last fall, U.S. Treasury Secretary Timothy Geithner told lawmakers that he and his team were working to put the $700 billion financial bailout fund "out of its misery." But some in Washington now see a second, backdoor bailout in its place.

On December 24, the Obama administration announced it was extending an unlimited credit line to mortgage finance agencies Fannie Mae (FNM.N) and (FRE.N) Freddie Mac, which would keep them afloat no matter how high their losses.

Representative Dennis Kucinich, an Ohio Democrat who was an early opponent of Obama in the 2008 presidential race, thinks the move is backdoor way to help banks, and a congressional subcommittee he leads is investigating the Treasury's decision to cover unlimited losses at the housing finance companies.

"This new authority must be used responsibly and for the benefit of American families," Kucinich said. It "cannot be used simply to purchase toxic assets at inflated prices, thus transferring the losses to the U.S. taxpayers and acting as a backdoor TARP."

That's exactly what Treasury is doing, says Dean Baker, co-director of the Center for Economic Policy Research in Washington.

"This looks like the original TARP," Baker said, referring to $700 billion financial rescue fund, known officially as the Troubled Asset Relief Program.

The original bailout program, devised by former Treasury Secretary Henry Paulson, "was a plan to help the banks restore their capital position by buying bad assets at and above market price, and that looks like what Fannie and Freddie will be doing if they are incurring losses of this magnitude."

The Treasury's announcement said the unlimited credit line for the two government-controlled companies would be in place through the end of 2012, weeks after Obama would face voters if he seeks a second term.

The Treasury also said it was scrapping plans for the two agencies, which play a role in funding three-fourths of all U.S. residential mortgages, to reduce the size of their investment portfolios. The 2010 limits on their portfolios, in fact, would allow their investment holdings to grow.

CALL TO ARMS

Kucinich is not the only one on Capitol Hill up in arms. House Energy and Commerce Committee Chairman Henry Waxman, a California Democrat, said he doesn't like the idea of a "blank check" for Fannie and Freddie.

And Darrell Issa, the top Republican on the House Oversight and Government Reform Committee, called it "a continuation of the bailout policies that have mortgaged away the future solvency of our country."

As the financial crisis unfolded in 2008, Paulson announced that the mortgage agencies would get an explicit guarantee from the federal government: $100 billion each. The Obama administration doubled that in early 2009 to $200 billion each. Combined, Fannie and Freddie have so far tapped about $111 billion.

Until the 2008 announcement, investors had seen their congressional charter and existing line of credit with Treasury as an implicit guarantee of support from the federal government.

The Obama administration now hopes its new, unlimited and even more explicit guarantee will bolster investor confidence and bring private sector buyers back into the market to help hold down mortgage costs.

But mortgage rates are expected to rise in the coming months as the Federal Reserve ends its $1.25 trillion program to purchase mortgage-backed securities at the end of this quarter. Freddie Mac sees the average rate on a 30-year, fixed-rate mortgage rising to 6 percent by the end of the year.

Higher mortgage rates could smother any emerging rebound in the still-fragile U.S. housing market, and a further decline in home prices could likely create more foreclosures.

That would leave many banks with even weaker portfolios. Banks could dump their toxic mortgage assets onto Fannie Mae and Freddie Mac, since their portfolio loan limits are now capped at $810 billion by the end of this year.

They had earlier been set to be 10 percent lower than 2009 year-end levels. Fannie said on December 28 its mortgage investments ended November at $752.2 billion, down 4.9 percent from the end of 2008. Freddie Mac's mortgage investment portfolio shrank in November to $761.8 billion, a 5.8 percent decline for the first 11 months of the year, the company said December 23. December figures are not yet available.

Treasury officials have said their move to allow unlimited losses for three years is merely precautionary. But the Center for Economic Policy Research's Baker said, "you only take precaution against conceivable events in the world."

He adds that it is hard to imagine that Fannie and Freddie would have losses of more than $400 billion from mortgages originated before September 2008, suggesting the agencies are incurring losses on what they have bought since 2008, "which should raise a lot of eyebrows."

The administration said it plans to lay out a vision for the future of the two agencies in the president's fiscal 2011 budget proposal in February. But officials caution against expecting too much detail.