



State of Play: Housing Finance

June 7, 2019

OUR VIEW

- FHFA director Mark Calabria has ramped up his public statements outlining possible options for administrative reforms to the housing finance system.

Our View: Calabria has sent a clear signal that his mission as FHFA director is to end the conservatorship of the GSEs. He has aggressively signaled that the status quo is over and the options that are available for a unilateral effort. Our view is that this helps to prime the market for possible upcoming decision points and for Calabria to gauge market reaction. We continue to believe that major reforms will be on a longer glide path than the frequency of his speeches would indicate. We expect a considerable transition period to be built into any reform decision (e.g. early decisions with later implementation on the GSE patch) because the end of conservatorship will be dependent on Fannie Mae and Freddie Mac's ability to raise capital.

- Treasury and HUD are due to submit reports to the President on GSE reform.

Our View: Treasury and HUD are working diligently to deliver a plan for legislative and administrative reforms to the U.S. housing finance system. Our expectation is that these reports will be finalized in mid-July. Our view is these reports will have less of an impact than originally expected. FHFA, while certainly working in close alignment with the administration, is an independent agency and Calabria has already started to socialize key reform concepts. Additionally, the loss of Treasury's Craig Philips removes a powerful voice from the report's implementation process.

- Chairman Mike Crapo (R-ID) still holds comprehensive GSE reform as a top priority this Congress.

Our View: Crapo and his staff are engaging potential bipartisan partners to evaluate whether there is a path forward on legislation for comprehensive GSE reform. Indeed, Calabria has stated publicly that he wants Congress to propose a legislative solution. On the other side of the Capitol, Chairwoman Maxine Waters (D-CA) has focused her attention on affordable housing, which will be a negotiating point for any legislative housing finance reform effort. Waters has signaled that she won't engage on broader reform discussions until the Senate demonstrates more progress. Our view is that Congress has a three- to four-

month window to demonstrate legislative progress before attention fully shifts to administrative action. Importantly, if a plan to release Fannie and Freddie from conservatorship excludes Congress, then the securities issued by the GSEs will not have an explicit guarantee.

WHAT TO WATCH

RFA is monitoring the following decision points:

- Senate Banking Committee activity in June – we expect Chairman Crapo will hold another hearing on housing finance.
- The finalization of FHFA's proposed rule on GSE capital will be a key initial signal for how much capital it will take to recapitalize and release Fannie and Freddie – how significant will the changes be to the proposed GSE capital rule?
- Craig Phillips' departure from Treasury is a blow to GSE reform and impacts Treasury's ability to influence the final outcome – will Secretary Mnuchin become personally engaged, or bring on an industry expert as a replacement?
- QM patch timing – the decision point on the QM patch expiration is a key element in shrinking the GSEs' footprint. Will the CFPB propose a rule this summer to repeal or reform the patch?
- UMBS goes live – the Single Security Initiative went live this week. The TBA market has already been trading. How will the market absorb the UMBS and what will this mean in the context of GSE reform?
- Senior Preferred Stock Purchase Agreement (PSPA) – will Treasury and FHFA reach an agreement to revise the PSPA by September or October? The end of the profit sweep could be the first real sign that the administration is heading down a path to recapitalization and release.

THE TIMELINE SO FAR

- **February 1, 2019** – Crapo releases an [outline](#) for housing finance reform
- **February 14, 2019** – Calabria testifies in his [SBC nomination hearing](#)
- **March 26-27, 2019** – [SBC hearings](#) on housing finance reform
- **March 27, 2019** – White House issues a [memo](#) directing Treasury and HUD to develop a plan for administrative and legislative reforms to housing finance
- **April 4, 2019** – Senate confirms Calabria's nomination to serve as FHFA director
- **June 3, 2019** – Fannie and Freddie launch the Uniform Mortgage-Backed Security

THE ADMINISTRATION



Mark Calabria was confirmed by the Senate in April to serve as the next FHFA director for a five-year term ending in 2024¹. On March 27th, the White House issued a [memo](#) directing Treasury and HUD to develop a plan for administrative and legislative reforms to the U.S. housing finance system. It gave several conditions for ending conservatorship, including:

- more capital held at Fannie Mae and Freddie Mac,
- a paid-for government backstop,
- additional guarantors authorized by FHFA, and
- a shrunken GSE portfolio and activities.

Treasury's Craig Phillips and HUD's Adolfo Marzol have led the efforts at their respective cabinets and are expected to release their reports in July. With Phillips's departure from Treasury and Marzol's appointment to be FHFA's Principal Deputy Director, Calabria and Marzol appear to be in the driver's seat. Treasury Secretary Steven Mnuchin has also weighed in publicly on housing reform – though he seemed open to either an explicit or implicit guarantee in the past, he told the Mortgage Bankers Association in October 2018 that there should be a paid-for explicit federal guarantee for mortgage-backed securities that doesn't put taxpayers at risk.

At the CFPB, director Kathy Kraninger is facing the fast-approaching expiration of the "GSE patch" to the Qualified Mortgage rule in January 2021 or when the GSEs exit conservatorship. The Bureau completed its statutorily-mandated [assessment](#) of the ATR/QM rule this January, setting the stage for future rulemaking to change or extend the patch. The CFPB's [spring 2019 regulatory agenda](#) notes that the Bureau is focusing on the GSE patch and highlighted that the patch was intended to be temporary and transitional. Changing the patch will be a key administrative reform to shrink Fannie and Freddie's portfolio and their footprint in the market, particularly the 30 percent that went to homebuyers exceeding the 43 percent debt-to-income ratio set by the QM rule. We expect a QM patch proposal before year-end.

¹ Calabria will continue to serve as FHFA director until 2024 even if Republicans lose the White House in 2020. Calabria can only be removed from office "for cause."

CONGRESS



Congress continues to assert its role in housing finance reform:

- Since Chairwoman Maxine Waters took the gavel of the House Financial Services Committee (HFSC), she has indicated that her priorities for housing finance are getting Fannie and Freddie "up and out of FHFA," protecting affordable housing goals and funding, maintaining access to the 30-year mortgage, and ensuring that sufficient private capital is in place to protect taxpayers.
- On the other side of the Hill, Senate Banking Committee (SBC) Chairman Mike Crapo released an [outline](#) for housing reform in February amid speculation that FHFA would be making unilateral administrative reforms. His model would turn Fannie and Freddie into two of several private guarantors; use Ginnie Mae to provide an explicit, paid-for government backstop for securitized mortgages; have FHFA set capital, liquidity, leverage, resolution, and stress test requirements for guarantors; and replace the current affordable housing goals and duty-to-serve requirements with a Market Access Fund.
- Both Crapo and Waters will have significant roles in any effort by the administration to reform housing finance unilaterally. Expect considerable oversight from the Senate Banking and House Financial Services Committees around actions related to affordability, pilot programs, and capital structures.

WORD AROUND TOWN



Since his confirmation to FHFA, Mark Calabria has given several important speeches and interviews that have attracted attention. We view these signals as an effort by an experienced political operator to (1) build momentum around Washington, (2) put pressure on Congress, and (3) invite stakeholders to provide thoughtful input to FHFA as part of an information-gathering phase. While only Congress can make structural

reforms like chartering new guarantors or providing an explicit government guarantee, FHFA can still make sweeping changes to housing finance. As conservator, Calabria can sell Treasury's stake in the GSEs, end the profit sweep and allow them to retain earnings, impose capital and other requirements, limit the size of loans that they purchase from originators, and raise guarantee fees. Furthermore, Calabria has indicated that FHFA will ask Congress for supervisory authorities akin to those of the OCC and FDIC. Our view is that Calabria's priorities are to end conservatorship of the GSEs, change what he views as an unsustainable status quo, and reduce taxpayer exposure in housing finance.

With Calabria's term ending in 2024, we believe that the trajectory for housing finance reform is longer term and that Calabria fully recognizes his role in a Republican administration going into an election year touting its stewardship over a strong economy. As a result, we do not believe that FHFA will do anything before Election Day 2020 that might disrupt the mortgage markets or make mortgage credit more expensive for consumers. The process to end conservatorship will likely take at least two years, if not more. Regardless of who occupies the White House after 2020, Calabria will still be at FHFA and cannot be removed unless "for cause," giving him a longer runway to operate. However, a Democratic win could put pressure on FHFA to slow down any reform efforts until the new president either signs off or goes in a different direction.

Once Treasury releases its report over the summer, we expect FHFA and Treasury to focus on the profit sweep and the PSPA, namely over the value of the existing ownership stakes in the GSEs. This will set the stage for Fannie and Freddie to begin raising capital – an estimated \$150 to \$250 billion. Calabria has said that he hopes to end the net sweep later this year and start the capital-building process by January, suggesting that the GSEs could raise money through an IPO by the first half of 2020.

UMBS GOES LIVE

As of Monday, the GSEs are issuing a common joint-venture security called the Uniform Mortgage-Backed Security (UMBS) through their joint Common Securitization Platform (CSP). It will trade in the TBA market for fixed-rate agency MBS. Previously, Fannie and Freddie issued MBS through separate programs, leading to differences in liquidity between Fannie MBS and Freddie Gold Participation Certificates. Considering the magnitude of the \$7.3 trillion U.S. agency mortgage market and the ongoing debate over GSE reform, we view the launch of the UMBS as an important milestone.

We believe that the implementation of the CSP and UMBS was done with GSE reform in mind and has the flexibility to be compatible with a new housing finance system, such as one with multiple guarantors. The UMBS makes it easier for a government guarantee to be applied to the securities themselves, rather than the guarantors, meaning that private guarantors could enter the market and start competing with Fannie and Freddie. For example, we can foresee a structure through which multiple issuers pool and issue securities in exchange for an explicit government guarantee. However, there is concern that it will be increasingly difficult the more guarantors there are, as they must align their programs and underwriting guidelines to keep the MBS nearly identical. It will be important to watch the market react to UMBS on a go-forward basis.