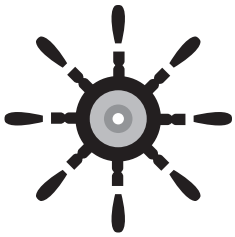
Fannie Mae, Freddie Mac, and Housing Finance Reform



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See also: *National Housing Trust Fund: Funding*

Fannie Mae and Freddie Mac, the two federally chartered companies that provide a secondary market for residential mortgages, have been in conservatorship since September 7, 2008 when the foreclosure crisis precipitated a global financial meltdown. Much to the dismay of many observers, the companies remain under the control of the federal government today because Congress cannot agree on what a future housing finance system should be.

The Housing and Economic Recovery Act of 2008 (HERA) established an independent agency, the Federal Housing Finance Agency (FHFA), to serve as Fannie and Freddie's regulator and significantly strengthen federal oversight of Fannie and Freddie. HERA gave the FHFA the power to take the companies into conservatorship if need be. HERA also created the National Housing Trust Fund (NHTF) and the Capital Magnet Fund (CMF).

Today, the Obama Administration and FHFA are determined that the companies stay in conservatorship until Congress acts on housing finance reform. Others, including affordable homeownership advocates and Fannie and Freddie stockholders, want the companies to be recapitalized and removed from conservatorship now. Because Fannie and Freddie provide the current and potentially future dedicated source of funding for the NHTF, their status and viability are of particular interest to low income housing advocates. NLIHC opposes recapitalization and supports reform legislation that would provide significant new funding for the NHTF.

WHAT ARE FANNIE MAE AND FREDDIE MAC

The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are government sponsored enterprises, known as GSEs. Congress established the GSEs to provide liquidity and create a secondary market for both single-family (one to four units) and multifamily (five or more units) residential mortgages. While Fannie and Freddie were created at different times and for different purposes, they have had effectively identical charters and responsibilities since 1992. Prior to September 7, 2008, when they were placed in conservatorship, they were privately owned and operated corporations.

Fannie and Freddie do not provide mortgage loans directly to individual borrowers. Rather, they facilitate the secondary mortgage market by buying loans from banks, savings institutions, and other mortgage originators. Lenders then use the sale proceeds to engage in further mortgage lending. For the most part, the GSEs purchase single-family, 30-year fixed rate conventional mortgages that are not insured by the federal government. They also play a major role in financing the multifamily housing market.

The GSEs either hold the mortgages they purchase in their portfolios or package them into mortgage-backed securities (MBSs), which are sold to investors. When the GSEs securitize a mortgage, they are guaranteeing that those investors receive timely payment of principal and interest. The GSEs charge mortgage lenders a guarantee fee (g-fee), generally in the form of monthly payments, to cover projected credit losses if a borrow defaults over the life of the loan.

The GSEs raise money in the capital markets to fund their activities. Their incomes come from the difference between the interest they receive on the mortgages they hold and the interest they pay on their debt, and from g-fees and income earned on non-mortgage investments.

Single-family mortgages. Single-family mortgages must meet certain criteria set by the GSEs to be packaged and sold as securities. As a result, the two GSEs set the lending standards for the conventional, conforming loan single-family mortgage market. This standardization increases the liquidity of mortgages meeting the GSE guidelines,

thereby decreasing the interest rates on these mortgages and lowering costs for homebuyers.

Generally, the GSEs provide support for 30-year fixed-rate mortgages on single-family homes. Fannie and Freddie can only purchase mortgages whose principal balance is equal to or less than the conforming loan limit established annually by FHFA. For FY16, the limit is $417,000 generally, with a maximum of $625,500 in areas with high home prices. The limit may also be adjusted to account for the size of a property.

Multifamily mortgages. The GSEs also purchase mortgages on multifamily properties. These mortgages are generally held in portfolio, but they can be securitized and sold to investors. Currently, Freddie and Fannie's combined purchases represent about just over 30% of the multifamily market. In the past, the GSEs have also played a significant role in supporting the Low Income Housing Tax Credit (LIHTC) market, but this support has decreased under conservatorship.

Housing goals. As GSEs, Fannie and Freddie are required to achieve social goals as well assure safety and soundness in the housing finance system. In exchange for an implied, now explicit, federal guarantee, Congress has required that the GSEs meet statutorily-based "housing goals" to help assure affordable homes in the U.S. The GSEs are required to purchase a certain number of mortgages on properties with specific characteristics to ensure that low and moderate income, underserved, and special affordable markets are served.

FHFA updates these goals periodically. In August 2015, FHFA published its final rule establishing the GSEs' housing goals for the 2015-2017 period. As required by HERA, the new goals include a single family purchase dollar goal for low income families, a single-family purchase dollar goal for families residing in low income areas, a single-family purchase dollar goal for very low income families, a single-family goal for the refinancing of mortgages for low income families, and a goal for the purchase of multifamily loans affordable to low income families.

There also is a multifamily subgoal targeting very low income families. The multifamily goals for the 2015-2017 period are higher than those that were set for the 2012-2014 period "to account for the overall size of the multifamily finance market, which has expanded substantially since the proposed rule was issued [in 2014]." In addition, FHFA boosted the subgoal for financing multifamily properties with units affordable to very low income families.

Substantial partisan disagreement remains over the affordable housing goals and the role of the federal government in the housing market. Progressives believe the goals are necessary to ensure that people with low incomes and people of color have access to mortgage markets. Conservatives believe the goals caused the GSEs to participate in overly risky business practices that triggered the foreclosure crisis. It is important to note that the multifamily side of the GSEs' business did not sustain losses during the crisis, but nor did the GSE multifamily goals lead to the expansion of rental housing affordable to families with extremely low incomes.

Duty-to-serve. HERA also established a "duty-to-serve" for the GSEs, which requires them to lead the industry in developing loan products and flexible underwriting guidelines for manufactured housing, affordable housing preservation, and rural markets. While FHFA has not implemented this provision, the agency published a proposed rule in December 2015 that outlines the GSEs' duty-to-serve.

The proposed rule requires the GSEs to submit plans for improving the "distribution and availability of mortgage financing in a safe and sound manner for residential properties that serve very low, low, and moderate income families." Each GSE would be required to submit to FHFA a three-year duty-to-serve plan, detailing the activities and objectives it will use to meet the rule's requirements. The proposed rule would give the GSEs duty-to-serve credit for eligible activities that facilitate a secondary market for residential mortgages that originate in underserved markets. The GSEs also will receive duty-to-serve credit for qualifying activities that promote residential economic diversity in underserved markets. The rule establishes the manner in which the GSEs would be evaluated for their efforts. FHFA is required to report evaluation findings to Congress annually.

FANNIE MAE, FREDDIE MAC, AND THE NHTF

In HERA, Congress established that Fannie and Freddie would serve as the initial sources of funding for the NHTF and the CMF. Fannie and Freddie are

required to set aside an amount equal to 4.2 basis points for each dollar of total new business purchases. Note that the assessment is on their volume of business, not their profits. Of these amounts, 65% is to go to the NHTF and 35% is to go to the CMF, after the first year when 25% must come off the top for the HOPE Reserve Fund, also created in HERA.

Lawmakers reasoned that requiring Fannie and Freddie to set aside funds for the NHTF was part of the GSEs' mission responsibilities included in their charters. In addition to their affordable housing goals, which could be met through the regular course of business, funding the NHTF allowed the GSEs to support housing that extremely low income renters could afford, activity that is not possible through any of their business products.

HERA allows FHFA to *temporarily* suspend the requirement the GSEs fund the NHTF and CMF under the circumstances related to threats to their financial health. In November 2008 at the height of the financial crisis, the FHFA director suspended this obligation before the GSEs even began setting aside funds. When the GSEs returned to profitability in 2012, NLIHC and others called on FHFA to lift the suspension. More than two years later in December 2014, FHFA Director Mel Watt did just that and directed both companies to begin setting aside the required amount starting on January 1, 2015. However, Mr. Watt did not lift the suspension retroactively, as advocates wanted. The first funds will be available in 2016. Based on Fannie and Freddie's 2015 reports to the Securities and Exchange Commission, NLIHC estimates that the NHTF will receive $186.6 million and the CMF will receive $100.4 million in 2016.

While lawmakers who support the NHTF praised Mr. Watt's decisions, opponents vehemently condemned his actions. On January 28, 2015, Representative Ed Royce (R-CA) introduced H.R. 574, a bill that would prohibit Fannie Mae and Freddie Mac from contributing to the NHTF and CMF as long as they remained in conservatorship or receivership. The bill has not received a hearing nor garnered support from other Members of Congress. During the FY16 appropriations season, House Republicans tried to raid the NHTF to make up for cuts to HUD appropriations. NHTF advocates pushed back and prevented the raid. However, NHTF advocates must continue to monitor and thwart legislative attempts to defund the NHTF.

FANNIE MAE AND FREDDIE MAC IN CONSERVATORSHIP

Before they were placed in conservatorship, Fannie and Freddie received no federal funds to support their operations. However, both companies incurred huge financial losses because of the foreclosure crisis, leading to them being placed in conservatorship. Today, FHFA has all the authority of each company's directors, officers, and shareholders. Until the conservatorship ends, FHFA operates the companies through appointed management in each company. During conservatorship the GSEs remain critically important to the housing finance system by providing liquidity for new mortgages, helping to resolve the mortgage crisis, and supporting the multifamily market.

Under an agreement between the Department of the Treasury and FHFA, the GSEs together were allowed to draw up to $200 billion to stay afloat, which bolstered the U.S. housing market. In exchange, the U.S. government became the owner of the companies' preferred stock. The total drawdown before 2012 was a combined $188 billion; that debt still exists.

In 2012, Fannie Mae and Freddie Mac returned to profitability, and began to make dividend payments to the Treasury. Under the conditions of the conservatorship agreement between Treasury and FHFA, all of Fannie and Freddie's profits are "swept" into the U.S. Treasury. The GSEs' dividend payments now far exceed the $188 billion or drawdown. Through November 5, 2015, Fannie Mae had paid $144.8 billion in cash dividends to Treasury and Freddie Mac has paid $96.5 billion, for a total of $241.3 billion.

In the last few years, there have been several federal lawsuits in which investors who have speculated on Fannie and Freddie stock are trying to end the government sweep of the GSEs' profits. Hedge funds have taken a gamble on investing in Fannie and Freddie shares with the hope that the courts would strike down the conservatorship agreement. The investors argue that the agreement violates their rights as shareholders, as they have been barred from receiving company dividends. Some lawsuits have already been thrown out of court, while others are pending.

Hedge funds and some civil rights and consumer advocacy groups have been pushing the Obama administration and FHFA to recapitalize and release the GSEs from conservatorship. They have authored several proposals, some that would provide funding for the NHTF. While the hedge funds stand to reap financial gains through "recap and release," the civil rights and consumer advocacy organizations argue that the indefinite conservatorship has created uncertainty in the mortgage market, leading mortgages lenders to tighten their credit standards in a way that disproportionally impacts racial minority homebuyers. They also contend that without recap and release, Fannie and Freddie's financial health will deteriorate, jeopardizing their obligation to contribute to the NHTF.

However, recap and release will not necessarily increase affordable lending and does not move Congress any closer to passing housing finance reform legislation, which promises to generate billions of new dollars for rental housing affordable to families with extremely low incomes. For this reason, NLIHC opposes recapitalization efforts.

HOUSING FINANCE REFORM PROPOSALS

Almost eight years after the financial crisis, policy makers are still grappling with how to reform the housing finance market. While some would like to nationalize the housing finance system and others would like to privatize it, most agree that a hybrid system of private capital backed by federal mortgage insurance is the preferred approach. Because of these philosophical differences, Members of Congress have reached a stalemate in pushing legislative proposals forward. While the Obama administration, many Members of Congress, and numerous analysts and pundits have wanted to end the conservatorships, wind down Fannie and Freddie, and establish a new model for the secondary mortgage market, all efforts to do so to date have been unsuccessful.

In the 113th Congress (2013-2014), considerable legislative activity on housing finance reform occurred, but by the end of 2014 no legislation was considered by either the full House or Senate. The greatest progress was made in the Senate, where the Democrats were in the majority.

Johnson-Crapo. In 2013, Senators Bob Corker (R-TN) and Mark Warner (D-VA) introduced the "Housing Finance Reform and Taxpayer Protection Act" (S. 1217), which laid out a plan to wind down Fannie and Freddie and replace them with a Federal Mortgage Insurance Corporation (FMIC), modeled after the Federal Depository Insurance Corporation (FDIC). The FMIC would have offered an explicit government guarantee, purchase and securitize single and multifamily mortgage portfolios, and provide regulatory oversight of the Federal Home Loan Banks. The bill would have assessed a 5-10 basis point user fee on all guaranteed securities that would be used to fund the NHTF, the CMF, and a new Market Access Fund (MAF). The bill would have abolished the affordable housing goals.

The Corker-Warner bill provided the framework for legislation subsequently offered by Senate Committee on Banking, Housing, and Urban Affairs Chair Tim Johnson (D-SD) and Ranking Member Mike Crapo (R-ID) that was introduced in the spring of 2014. The measure would have replaced the GSEs with a new FMIC. To be eligible for reinsurance under the FMIC, any security must have first secured private capital in a 10% minimum first loss position. The bill also established a new securitization platform to create a standardized security to be used for all securities guaranteed by the new system. The securitization platform would have been regulated by the FMIC.

The bill included a 10 basis point user fee to fund the NHTF, the CMF, and the new MAF. The fee was projected to generate $5 billion a year, and 75% of the funds would go to the NHTF. While the bill also got rid of the affordable housing goals, it included a new "flex fee" or "market incentive" to encourage mortgage guarantors and aggregators to do business in underserved areas.

The Johnson-Crapo bill also provided for a secondary market for multifamily housing. It allowed for the Fannie and Freddie multifamily activities to be spun off from the new system established by the bill. The bill would have required that at least 60% of the multifamily units securitized must be affordable for low income households (80% AMI or less). The bill would have also created a pilot program to promote small (50 or fewer units) multifamily development.

The Johnson-Crapo bill was voted out of the Senate Banking Committee on May 15, 2014 by a bipartisan vote of 13-9.The Obama Administration fully endorsed the bill. But the bill was criticized by the

right and the left for doing too much or not enough to assure access to mortgages to all credit worthy borrowers and was never taken up by the full Senate.

Delaney-Carney-Himes. Representatives John Delaney (D-MD), John Carney (D-DE), and Jim Himes (D-CT) introduced the "Partnership to Strengthen Homeownership Act" (H.R. 5055) in 2014, which would have wound down Fannie and Freddie over a five-year period and create a mortgage insurance program run through the Government National Mortgage Association (Ginnie Mae). Ginnie Mae would become a stand-alone agency, no longer part of HUD. Fannie and Freddie would eventually be sold off as private institutions without any government support.

The bill would have provided a full government guarantee on qualifying mortgage securities backed by mortgages that meet certain eligibility criteria. As proposed, private capital would have had a minimum 5% first-loss risk position. The remaining risk would have been split between Ginnie Mae and private reinsurers, with private capital covering at least 10% of losses. Fannie and Freddie's multifamily activities would have been spun off and privatized, and receive a government guarantee through Ginnie Mae.

In return for insuring securities, Ginnie Mae would have charged a fee of 10 basis points on the total principal balance of insured mortgages. The bill would apply 75% of this fee revenue to the NHTF, 15% to the CMF, and 10% to the MAF. This is identical to how the Johnson-Crapo and Waters (below) bills treat the NHTF. However, unlike other the other bills, this measure would have added Federal Housing Administration (FHA) mortgages in the determining the base upon which the 10 basis point fee is assessed, generating an additional $1 billion.

Housing Opportunities Move the Economy (HOME) Forward Act. House Committee on Financial Services Ranking Member Maxine Waters (D-CA) released draft housing finance reform legislation, the "Housing Opportunities Move the Economy (HOME) Forward Act," in 2014. The measure would have wound down Fannie and Freddie over a five-year period and replaced them with a newly created lender-owned cooperative, the Mortgage Securities Cooperative (MSC). The MSC would have been the only entity that could issue government guaranteed securities and would have been lender-capitalized based on mortgage volume. The bill would have also created a new regulator, the National Mortgage Finance Administration (NMFA). Under the bill, private capital would have to have been in a first loss position to reduce taxpayer risk.

The HOME Forward Act would have preserved Fannie and Freddie's multifamily business and transferred it to a new multifamily platform at the MSC. The bill also assessed a 10 basis point user fee to fund the NHTF, the CMF, and the MAF. It does not continue the housing goals. The bill was never introduced.

PATH Act. House Committee on Financial Services Chair Jeb Hensarling (R-TX) introduced the "Protecting American Taxpayers and Homeowners (PATH) Act" (H.R. 2767) in 2013. The bill called for a five-year phase out of Fannie and Freddie. As part of this wind-down, the bill would have repealed the authorization of the current affordable housing goals, as well as the NHTF and CMF. The bill would have established a new non-government, non-profit National Mortgage Market Utility (Utility) that would have been regulated by FHFA and required to think of and develop common best practice standards for the private origination, servicing, pooling, and securitizing of mortgages. The Utility would have also operated a publicly accessible securitization outlet to match loan originators with investors. The Utility would not have been allowed to originate, service, or guarantee any mortgage or MBS.

The bill would have also made changes to FHA, including making it a separate agency, no longer part of HUD. The bill would have limited FHA's activities to first-time homebuyers with any income and low and moderate-income borrowers and would have lowered the FHA conforming loan limit for high-cost areas. The bill was voted out of the Financial Services Committee on July 23, 2013 by a partisan vote of 30-27. Two Republicans and all Democrats opposed the bill. The bill was not taken up by the full House, blocked by then Speaker of the House John Boehner (R-OH). It was opposed by virtually every segment of the housing industry.

HOUSING FINANCE REFORM IN THE 114TH CONGRESS

There appears to be little political will to move reforms forward in the 114th Congress and legislation is highly unlikely in 2016. A few bills

have been introduced to that include partial reforms, but only one—reintroduction of the Delaney-Carney-Himes proposal (H.R. 1491)—has offered a comprehensive proposal for reform. There have been no hearings in either chamber.

Senate Banking Chair Richard Shelby (R-AL) introduced a broad regulatory reform bill (S. 1484) that would maintain the GSEs, but would include several reforms, including lowering taxpayer risk while continuing to provide private-market access to a common securitization platform. The bill was voted out of the Committee by a party-line vote and later attached to the Senate FY16 Financial Services and General Government Appropriations spending bill. However, the measure was not included in the final spending bill for FY16.

There have also been several measures introduced that would end the Treasury's sweep of Fannie and Freddie's profits and allow them to recapitalize. Representative Mike Capuano introduced H.R. 1036, the "Let the GSEs Pay Us Back Act" on February 24, 2015. The bill would alter the current arrangement between the GSEs and Treasury to allow the two companies to repay the money they received from the Treasury during the financial crisis.

The bill would require a new agreement modifying the conservator agreement to allow payments that Fannie and Freddie have made to Treasury to count towards paying down their debt. Any GSE senior preferred stock purchased by the Treasury would no longer accrue dividends, as is current practice. The amounts of federal funds the GSEs received prior to the modification would be treated as a loan made by the Treasury to a GSE that would have to be repaid, and current dividend payments would be treated as payments of principal and interest under the loan. Fannie and Freddie would be able to keep profits above the repaid amount, allowing them to recapitalize.

Representative Marsha Blackburn (R-TN) introduced the "Enterprise Secondary Reserve Taxpayer Protection and Government Accountability Act of 2015" (H.R. 1673) that would require profits to be placed in a secondary reserve fund that would cover any losses incurred by Fannie and Freddie due to a housing downturn. Under H.R. 1673, the FHFA Director would decide whether to use funds held in the reserve if Fannie or Freddie's losses exceed their capital reserves. Funds in the secondary reserve would not be considered part of Fannie and Freddie's "capital, capital reserve, or otherwise an asset of the enterprise" other than as part of an approved capital restoration plan.

Representative Mick Mulvaney (R-SC) had planned to introduce legislation by the end of 2015 that would have considered the GSEs' debts repaid and released them from conservatorship after they built up their capital reserves. To win bipartisan support, Mr. Mulvaney included a provision in the draft bill that would require the GSEs to provide $1 billion to the NHTF and CMF but only if the GSEs reached and maintained $5 billion in capital reserves. However, Mr. Mulvaney has yet to introduce his bill.

The Obama Administration has explicitly expressed its opposition to allowing the GSEs to recapitalize. These bills stand little chance of being enacted in 2016.

The FY16 omnibus spending bill contained an amendment, offered by Senators Bob Corker (R-TN) and Mark Warner (D-VA), which further blunts attempts to recapitalize Fannie and Freddie. Based on Senators Corker and Warner's bill, the "Jumpstart GSE Reform Act" (S. 2038), the amendment prohibits Treasury from selling any of the Fannie and Freddie stock without Congressional approval. Senators Warner and Corker, members of the Senate Banking Committee and key proponents of housing finance reform, hope that this will revive comprehensive housing finance reform effort http://nlihc.org/issues/nhtf/implementations.

NLIHC supports the prohibition on the sale of stock and recapitalization of the GSEs and will continue to advocate for comprehensive reform, since it offers the best chance of substantial new funding for NHTF in the coming years. When Congress does finally tackle housing finance reform, it is critical that low income housing advocates remain vigilant and protect the gains made in the Johnson-Crapo, Waters, and Delaney-Carney-Himes bills to robustly fund the NHTF.

WHAT TO SAY TO LEGISLATORS

Fannie Mae and Freddie Mac play important roles in both the single-family and the affordable multifamily markets. These functions, as well as the contributions to the NHTF, need to be part of

any future secondary market. The NHTF must be retained and funded in any future housing finance system.

With respect to the potential housing finance reform proposals, advocates should urge their legislators to:

- Oppose any legislation that would eliminate or prohibit funding for the NHTF.
- Support legislation that provides a robust source of funding for the NHTF similar to the Johnson-Crapo, Waters, and Delaney-Carney-Himes bills.
- Support housing finance reform legislation that assures access to the market for all credit worthy borrowers, as well as assuring compliance with federal fair housing laws.
- Oppose efforts to recapitalize Fannie and Freddie before Congress passes comprehensive housing finance reform legislation.

FOR MORE INFORMATION

Federal Housing Finance Agency, www.fhfa.gov

Federal Home Loan Mortgage Corporation, www.fanniemae.com

Federal National Mortgage Association, www.freddiemac.com ■