Fannie Mae, Freddie Mac, and Housing Finance Reform

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See also: *National Housing Trust Fund: Funding*

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

Both companies were hit hard by the mortgage foreclosure crisis in the late 2000s. In September 2008 they were placed under the conservatorship of the Federal Housing Finance Agency (FHFA), their regulator. While Fannie Mae and Freddie Mac have since stabilized and returned to profitability, they remain in conservatorship. The FHFA was created in the Housing and Economic Recovery Act (HERA) of 2008, which significantly strengthened federal oversight of Fannie Mae and Freddie Mac.

Today, FHFA has all the authority of each company's directors, officers, and shareholders. Until the conservatorship ends, the FHFA, led by Director Mel Watt, operates the companies through appointed management in each company. The GSEs remain critically important to the housing finance system by providing liquidity for new mortgages and supporting the multifamily market.

WHAT ARE FANNIE MAE AND FREDDIE MAC

The GSEs do not make mortgage loans directly to individual borrowers. Instead, they carry out their secondary market functions by buying mortgages from banks, savings institutions, and other mortgage originators. This allows lenders to free up dollars with which to buy new mortgages. The companies primarily purchase single-family, 30-year fixed rate mortgages that are not insured by the federal government. They also support the multifamily rental market. The GSEs either hold the mortgages they purchase in their portfolios or package them into securities, known as mortgage-backed securities (MBS), which they sell to investors. Most mortgages are securitized, that is, pooled into MBSs,

When the GSEs securitize a mortgage, they are guaranteeing the timely payment of interest and principal to the purchaser of the MBS. In order for single-family mortgages to be packaged and sold as securities, they must meet certain standardized criteria set by the GSEs. As a result, the two GSEs set the lending standards for the conventional, conforming-loan single-family mortgage market. This standardization has the benefit of increasing the liquidity of mortgages meeting the GSE guidelines, thereby decreasing the interest rates on these mortgages and lowering costs for the homebuyers.

Single-family mortgages. Generally, the GSEs provide support for 30-year fixed-rate mortgages on single-family homes. Fannie and Freddie can - purchase only mortgages whose principal balance is equal to or less than the conforming loan limit established annually by FHFA. For FY15, the limit is $417,000 generally, with a maximum of $625,500 in areas with high home prices. The limit is also adjusted for property size and higher limits apply in Alaska, Guam, Hawaii, and the U.S. Virgin Islands.

To help make mortgages more accessible to otherwise creditworthy borrowers, FHFA announced in December 2014 that it would allow Fannie and Freddie to guarantee single-family mortgages with only 3% down payments for qualified first time homebuyers.

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 Mac and Fannie Mae's combined purchases represent about 45% of the U.S. multifamily market. In the past, Freddie Mac and Fannie Mae 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. The GSEs are chartered by the federal government, and thus have the responsibility to help ensure decent affordable homes in the United States. This responsibility is represented by statutorily based "housing goals." The GSEs are required to meet certain percentage-of-purchase goals to ensure that they serve low and moderate income markets, underserved markets, and special affordable markets. In other words, the GSEs are each required to purchase a certain number of mortgages on properties that meet certain characteristics.

These goals are adjusted periodically. In November 2012, FHFA published housing goals for the 2012-2014 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 goal for the purchase of multifamily loans affordable to low income families. There is also a multifamily subgoal targeting very low income families. The goals for the 2012-2014 period are lower than those that were set for the 2010-2011 period, in part because FHFA believes that the GSEs should have a smaller footprint in the market. In August 2014, FHFA issued a proposed rule to set the GSE's housing goals through 2017. The agency is currently evaluating public comments that were submitted and finalizing the rule.

HERA also created a new "duty to serve" requirement, which requires the enterprises to lead the industry in developing loan products and flexible underwriting guidelines for manufactured housing, affordable housing preservation, and rural markets. FHFA has not yet implemented this requirement.

The housing goals are a major source of partisan disagreement about Fannie and Freddie and the role of the federal government in the U.S. housing market. Progressives believe the goals are necessary to ensure access to mortgage lending for low income people and people of color. Conservatives believe the goals caused Fannie and Freddie to engage in risky practices that led to the foreclosure crisis.

It is important to note that the multifamily side of the GSEs' business did not sustain losses during the financial crisis. Nor did the GSE multi-family goals lead to the expansion of rental housing that extremely low income people can afford.

FANNIE MAE, FREDDIE MAC, AND THE NHTF

HERA established Freddie Mac and Fannie Mae as the initial sources of funding for the National Housing Trust Fund (NHTF) and Capital Magnet Fund (CMF). Fannie Mae and Freddie Mac were required to set aside an amount equal to 4.2 basis points for each dollar of total new business purchases. Of these amounts, 65% would be used to fund the NHTF and 35% would be directed to the CMF. Note that the assessment is on their volume of business, not their profits.

The rationale for an assessment on Fannie and Freddie to pay for the NHTF is based in their social mission responsibilities. In addition to their goals, which they could meet through the regular course of business, funding the NHTF allowed them to support housing affordable to extremely low income renters, activity that is not possible through any of their business products.

HERA allows FHFA to *temporarily* suspend the requirement the GSEs to fund the NHTF and CMF under circumstances that threaten their financial health. In November 2008, FHFA did suspend any such payments before they even started. When Fannie and Freddie 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 lifted the suspension and directed both companies to begin setting aside the required amount starting on January 1, 2015. Mr. Watt did not lift the suspension retroactively, as advocates wanted. The first funds will be available in early 2016.

Mr. Watt's action was praised by NHTF supporters and condemned by NHTF detractors in Congress. On January 28, 2015, Representative Ed Royce (R-CA) introduced H.R. 574, a bill to prohibit contributions by Fannie Mae and Freddie Mac to the NHTF and CMF as long as Fannie Mae and Freddie Mac remain in conservatorship or receivership.

FANNIE MAE AND FREDDIE MAC IN CONSERVATORSHIP

Prior to their being placed in conservatorship, the GSEs had received no federal funds to support their operations. Instead, Fannie Mae and Freddie Mac raised money in the capital markets to fund their activities. The GSEs' incomes come from the difference between the interest they receive on the mortgages they hold and the interest they pay on their debt, from the fees they charge to investors for guaranteeing payment on the mortgage-backed securities they issue, and from income earned on non-mortgage investments.

Both Fannie Mae and Freddie Mac sustained substantial losses as a result of the foreclosure crisis, which led to their conservatorship. Under an agreement between the Department of the Treasury and FHFA, the GSEs together were allowed to draw up to $200 billion to keep afloat, which essentially kept the U.S. housing market from collapsing. In exchange, the U.S. government became the owner of preferred stock of the companies.

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. These amounts now far exceed the $188 billion that Fannie and Freddie received in the first years of the financial crisis. Through September 30, 2014, Fannie Mad had paid $130.5 billion in cash dividends to Treasury and Freddie Mac has paid $88.2 billion, for a total of $218.7 billion.

HOUSING FINANCE REFORM PROPOSALS

The Obama Administration, many Members of Congress, and numerous analysts and pundits want to end the conservatorships, wind down Fannie Mae and Freddie Mac, and establish a new model for the secondary mortgage 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.

Several reform proposals emerged in the 113th Congress, but none progressed past the committee stage. They include:

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 Mae and Freddie Mac. 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 "establish(ed) a new non-government, not-for-profit National Mortgage Market Utility (Utility) regulated by the Federal Housing Finance Administration (FHFA) to develop common 'best practices' standards for the private origination, servicing, pooling, and securitizing of mortgages, and operate a publicly accessible securitization outlet to match loan originators with investors." The Utility would not be allowed to originate, service, or guarantee any mortgage or mortgage backed security.

The bill would also have made changes to the Federal Housing Administration (FHA), including making FHA 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. It was opposed by virtually every segment of the housing industry.

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, purchased and securitized single and multifamily mortgage portfolios, and provided 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 would have 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. Johnson-Crapo allocated 75% of the funds raised for NHTF. While the bill also abolished 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 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 to be affordable for low income households (80% AMI or less). The bill would also have 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 ensure access to mortgages to all credit worthy borrowers and was never taken up by the full Senate.

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 Mae and Freddie Mac over a five year period and replaced them with a newly created lender-owned cooperative, the Mortgage Securities Cooperative (MSC). The MSC would be the only entity that could issue government guaranteed securities and would be lender-capitalized, based on mortgage volume. The bill would also have created a new regulator, the National Mortgage Finance Administration (NMFA). Under the bill, private capital would have to be 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 did not continue the housing goals. The bill was never introduced.

Delaney-Carney-Himes. Representatives John Delaney (D-MD), John Carney (D-DE) and Jim Himes (D-CT) introduced H.R. 5055, the "Partnership to Strengthen Homeownership Act," which would have wound down Fannie Mae and Freddie Mac over a five-year period and created a mortgage insurance program run through the Government National Mortgage Association (Ginnie Mae). Ginnie Mae would have become a stand-alone agency, no longer part of HUD.

Fannie and Freddie would eventually have been 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 have applied 75% of this fee revenue to the NHTF, 15% to the CMF, and 10% to the MAF, identical to what the Johnson-Crapo and Waters bills would have done for the NHTF. However, unlike other the other bills, H.R. 5055 added FHA mortgages in the determining the base upon which the 10 basis point fee would be assessed.

As the *Advocate's Guide* goes to press, it is too early to make predictions about prospects for housing finance reform in the 114th Congress. Some things for advocates to keep in mind are:

- The Senate Banking Committee has a new Chair, Senator Richard Shelby (R-AL), and a new Ranking Member, Senator Sherrod Brown (D-OH). Both voted against the Johnson-Crapo bill in 2014. It remains to be seen if the committee will work on housing finance reform this year.
- Chairman Hensarling is expected to introduce a housing finance reform bill again, but there is speculation that it will be more moderate than the PATH Act in order to attract more support from moderate Republicans and Democrats.
- Representatives Delaney, Carney, and Himes likely will introduce an updated version of their bill from the last Congress.
- The pressure for reform and replacing Fannie Mae and Freddie Mac is mitigated somewhat by the fact that under conservatorship, most of their profits (tens of billions of dollars) are going to the federal Treasury, helping to reduce the deficit.
- **Most importantly**, low income housing advocates must be **vigilant to protect the gains** made on the NHTF in the Johnson-Crapo, Waters, and Delaney-Carney-Himes bills in the last Congress.

WHAT TO SAY TO LEGISLATORS

Freddie Mac and Fannie Mae 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 the next iteration of the PATH Act and any other legislation that proposes to eliminate the NHTF.
- Support the treatment of the NHTF in the Johnson-Crapo, Waters, and Delaney-Carney-Himes Johnson-Crapo and Waters bills in any new legislation.
- Support housing finance reform legislation that ensures access to the market for all credit worthy borrowers, as well as ensuring compliance with federal fair housing laws. ■

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