Fannie Mae, Freddie Mac, and Housing Finance Reform

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See Also: For related information, refer to the *National Housing Trust Fund: Funding* section of this guide.

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, the companies remain under the control of the federal government because Congress cannot agree on a housing finance system.

The "Housing and Economic Recovery Act of 2008" (HERA) established an independent agency, the Federal Housing Finance Agency (FHFA), to serve both as a regulator and to significantly strengthen federal oversight of Fannie Mae and Freddie Mac. HERA gave the FHFA power to take the companies into conservatorship. HERA also created the national Housing Trust Fund (HTF) and the Capital Magnet Fund (CMF).

Because Fannie Mae and Freddie Mac provide the dedicated source of funding for the HTF, their status and viability are of particular interest to low-income housing advocates. NLIHC supports housing finance legislation that would provide significant new funding for the HTF.

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. Although Fannie Mae and Freddie Mac were created at different times and for different purposes, they have had effectively identical charters and responsibilities since 1992. Before September 7, 2008, when they were placed in conservatorship, they were privately owned and operated corporations.

Fannie Mae and Freddie Mac 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 borrower 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 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 Mae and Freddie Mac can only purchase mortgages with principal balances equal to or less than the conforming loan limit established annually by FHFA. 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. In the past, the GSEs have also played a significant role in supporting the Low-Income Housing Tax Credit market.

HOUSING GOALS

As GSEs, Fannie Mae and Freddie Mac are required to achieve social goals as well as assure safety and soundness in the housing finance system. Congress requires 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.

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. Some believe that 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; unfortunately, the GSE multifamily goals did not 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. FHFA published its final rule in December 2016, which outlines the GSEs' duty-to-serve.

The final 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 is 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 final rule gives the GSEs duty-to-serve credit for eligible activities that facilitate a secondary market for residential mortgages that originated in underserved markets. The GSEs also 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.

Under ordinary circumstances, each GSE would have submitted a three-year Plan for 2021-2023 in accordance with the Duty to Serve mandate. Because of the uncertainty as a result of the COVID-19 pandemic, FHFA directed the GSEs to submit Plans for one year (2021) only, as an extension of their 2018-2020 Plans. For 2022, GSEs went back to their usual two-year Plan, so new Duty to Serve Plans will last from 2022-2024.

The GSE's Duty to Serve plan for 2025-2027 went into effect January 1, 2025.

Fannie Mae, Freddie Mac, and the Housing Trust Fund

In HERA, Congress established that Fannie Mae and Freddie Mac would serve as the initial sources of funding for the HTF and the CMF. Fannie Mae and Freddie Mac 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 HTF and 35% is to go to the CMF.

Lawmakers reasoned that requiring Fannie Mae and Freddie Mac to set aside funds for the HTF 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 HTF allowed the GSEs to support housing that extremely low-income renters could afford. This was not possible through any other business product.

HERA allows FHFA to temporarily suspend the requirement that the GSEs fund the HTF and the CMF under 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. In 2014, FHFA Director Mel Watt lifted the suspension and directed both companies to begin setting aside the required amount starting on January 1, 2015. Since 2016, more than $3 billion has been invested in the HTF. This is an important start, but more HTF resources are needed to begin to address the shortage of 7.3 million decent, accessible, and affordable, homes for households with the lowest incomes.

Fannie Mae and Freddie Mac in Conservatorship

Before the financial crisis, Fannie Mae and Freddie Mac had never received any federal funds to support their operations. However, both companies incurred financial losses because of the foreclosure crisis. This prompted Congress to place the companies in conservatorship under the FHFA. 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.

In 2012, Fannie Mae and Freddie Mac returned to profitability and began to make dividend payments to Treasury. Under the conditions of the conservatorship agreement between Treasury and FHFA, all of Fannie Mae and Freddie Mac's profits outside of a $3 billion buffer were "swept" into the U.S. Treasury. In the final days of the first Trump Administration, FHFA agreed to allow the GSEs to retain a combined $45 billion worth of earnings before making dividend payments to Treasury. The GSEs' dividend payments now far exceed the $188 billion drawdown.

In recent years, several federal lawsuits have attempted to end the government sweep of the GSEs' profits. Hedge funds gamble on investing in Fannie Mae and Freddie Mac 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. The Supreme Court dismissed some claims made by hedge funds in 2021 that FHFA had overstepped its authority when requiring the GSEs to sweep profits to Treasury. More recently, however, in *Berkley Insurance Co. v. FHFA,* a federal court found that FHFA breached an implied covenant of good faith and that its actions harmed shareholders, awarding investors $612 million in damages.

Hedge funds and some civil rights and consumer advocacy groups have been pushing to recapitalize and release the GSEs from conservatorship. They have authored several proposals, some that would provide funding for the HTF. Although 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 mortgage lenders to tighten their credit standards in a way that disproportionately impacts racial minority homebuyers. They also contend that without recap and release, Fannie Mae and Freddie Mac's financial health will deteriorate, jeopardizing their obligation to contribute to the HTF.

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.

Housing Finance Reform Proposals

More than a decade after the financial crisis, policy makers are still grappling with how to reform the housing finance market. Due to philosophical differences, members of Congress have reached a stalemate in pushing legislative proposals forward. Although many members of Congress and numerous analysts and pundits have wanted to end the conservatorships, wind down Fannie Mae and Freddie Mac, and establish a new model for the secondary mortgage market, all efforts to do so to date have been unsuccessful.

Considerable legislative activity on housing finance reform occurred in the 113th Congress (2013-2014), even though no legislation was considered by either the full House or Senate.

JOHNSON-CRAPO

In 2013, former Senator Bob Corker (R-TN) and Senator Mark Warner (D-VA) introduced the "Housing Finance Reform and Taxpayer Protection Act" (S. 1217), which laid out a plan to wind down Fannie Mae and Freddie Mac and replace them with a Federal Mortgage Insurance Corporation (FMIC), modeled after the Federal Depository Insurance Corporation. 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 HTF, the CMF, and a new Market Access Fund (MAF). The bill would have abolished 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 Johnson-Crapo measure would have replaced the GSEs with a new FMIC. To be eligible for reinsurance under the FMIC, any security must first secure private capital in a 10% minimum first loss position. The bill also established a new securitization platform to create 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 HTF, 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 HTF. Even though the bill removed 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 Mae and Freddie Mac 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 for doing too much or not enough to assure access to mortgages to all creditworthy borrowers, and it 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 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 become a stand-alone agency, no longer part of HUD. Fannie Mae and Freddie Mac 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 Mae and Freddie Mac's multifamily activities would have been spun off and privatized and received 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 HTF, 15% to the CMF, and 10% to the MAF. This is identical to how the Johnson-Crapo and Waters (below) bills treat the HTF. However, unlike other the other bills, this measure would have added Federal Housing Administration (FHA), Department of Agriculture (USDA), and Veterans Affairs (VA) 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"

Congresswoman 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 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. 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 Mae and Freddie Mac'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 HTF, the CMF, and the MAF. The bill was never introduced.

"PROTECTING AMERICAN TAXPAYERS AND HOMEOWNERS (PATH) ACT"

Former Congressman 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 HTF 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 and was blocked by then Speaker of the House John Boehner (R-OH). It was opposed by virtually every segment of the housing industry.

"BIPARTISAN HOUSING FINANCE REFORM ACT OF 2018"

Representatives Hensarling, Delaney, and Himes released draft legislation to reform the nation's housing finance system in 2018. This proposal provided an affordability fee that could contribute to an overall increase in funding dedicated to affordable housing. While NLIHC appreciated the authors' stated commitment to "substantial funding in support of existing programs that contribute to the development of the supply of affordable housing options for low-income individuals and communities, such as the Housing Trust Fund and the Capital Magnet Fund," we were concerned with the lack of details about the size of the fee and the uses for the funds generated. While the draft bill provided few details on how much funding would be provided to the HTF, the authors specifically identified the HTF as a possible recipient of such funds. Moreover, the bill was unclear about the size of the assessment. NLIHC opposes the draft bill's suggestion that dedicated funds be on budget, and instead NLIHC urges lawmakers to ensure that HTF funding remains separate from the appropriations process.

Funding for the HTF must be part of a broader commitment to ensuring access and affordability throughout the housing market. The draft legislation, however, would repeal the system's current affordable housing goals without providing anything in its place. This is unacceptable; housing finance reform must include enforceable and measurable mechanisms to ensure that access to credit is enjoyed by all segments of the housing market.

State of Play in 2025

With the election of President Trump in 2024, Republicans may renew efforts to remove the GSEs from conservatorship and privatize them, a complex process that may take years to complete. In doing so, the Administration may try to sidestep Congress. This approach has significant risks, and many worry that it could lead to higher housing prices and undermine the stability of the mortgage market.

NLIHC will continue to advocate for comprehensive reform legislation, since it offers an important opportunity to expand the HTF in the coming years. If 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 HTF.

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 HTF, need to be part of any future secondary market. The HTF 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 HTF.
- Support legislation that provides robust funding for the HTF similar to the Johnson-Crapo and Waters and Delaney-Carney-Himes bills.
- Support housing finance reform legislation that assures access to the market for all creditworthy borrowers, as well as assuring 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.