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FHFA Calls For Big Changes to Fannie/Freddie Conservatorship

Federal Housing Finance Agency (FHFA) Director Mel Watt had three messages for the U.S. Senate Committee on Banking, Housing, and Urban Affairs on Thursday:

- Fannie Mae and Freddie Mac (the GSEs) are not the companies they were before they were put in conservatorship
- Congress needs to act urgently on housing finance reform; and
- The current financial strictures on the GSEs are not sustainable.

It was the third message that will probably **grab the most attention**. In delivering it, Watt appeared to serve notice that he is ready to end the net worth sweep that will ultimate reduce the capital held by the GSEs to zero at the beginning of 2018.

Watt, who has been director of FHFA since 2014, reminded members of the Senate committee that the GSEs are in their **ninth year** under FHFA conservatorship and during his term he has found that FHFA and the GSEs operate with responsibilities "that make it impossible to satisfy everyone and sometimes make it impossible to satisfy anyone."

Watts said the **most significant challenge** his agency current faces is one he first raised publicly in February 2016. Under terms of the GSEs' Preferred Stock Purchase Agreement (PSPA) with the Treasury Department, the amount of taxpayer support still available to Fannie Mae is $117.6 billion and Freddie Mac has a remaining draw of $140.5 billion. Additional draws will reduce these commitments further; however, dividend payments do not replenish or increase the commitments. "There is a foreseeable risk," he said, "that the uncertainty associated with such draws or from the reduction in committed taxpayer backing could adversely impact the housing finance market."

Unfortunately, the challenge is significantly greater today than it was when Watt first raised the issue. Then each GSE had a $1.2 billion buffer under the terms of the PSPA against having to make additional draws of taxpayer support in the event of an operating loss in any quarter. That buffer has now been reduced to $600 million and on January 1, 2018 it will reduce to zero. "At that point, neither Enterprise will have the ability to weather any loss it experiences in any quarter without drawing further on taxpayer support."

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	6.27%	-0.08	0.00
15 Yr. Fixed	5.65%	-0.20	0.00
30 Yr. FHA	5.67%	-0.05	0.00
30 Yr. Jumbo	6.49%	-0.06	0.00
5/1 ARM	6.05%	-0.16	0.00
Freddie Mac			
30 Yr. Fixed	6.35%	-0.51	0.00
15 Yr. Fixed	5.47%	-0.69	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	6.44%	-0.06	0.54
15 Yr. Fixed	5.88%	-0.16	0.68
30 Yr. FHA	6.36%	-0.06	0.85
30 Yr. Jumbo	6.75%	+0.07	0.39
5/1 ARM	5.98%	-0.27	0.65

Rates as of: 9/6

Recent Housing Data

		Value	Change
Mortgage Apps	Aug 28	226.9	+0.49%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%

		Value	Change
Builder Confidence	Mar	51	+6.25%

Watt says his is **not a theoretical concern**. Generally accepted accounting principles (GAAP) used for any number of non-credit related factors such as interest rate volatility or treatment of derivatives, regularly result in large fluctuations in GSE gains or losses. There are also short-term consequences from corporate tax returns; the greater the reduction in the corporate tax rate, the greater the short-term losses to the GSEs would be. In addition, even minor housing market disruptions or short periods of distress in the economy could also cause credit-related losses in a given quarter.

Every business needs a **buffer against short-term operating losses**, he said, and it is especially irresponsible for the GSEs to lack one of any kind. Even a one quarter loss would result in an additional Treasury draw and reduce the fixed commitment Treasury has made to support the GSEs. This could erode investor confidence, stifle liquidity and the mortgage-backed securities market, and increase the cost of mortgage credit for borrowers.

Watt said his agency has explicit statutory obligations to ensure that each Enterprise "operates in a safe and sound manner" and fosters "liquid, efficient, competitive, and resilient national housing finance markets," and cannot risk the loss of investor confidence. "It would, therefore, be a serious misconception for members of this Committee, or for anyone else, to consider any actions FHFA may take as conservator to avoid additional draws of taxpayer support either as interference with the prerogatives of Congress, as an effort to influence the outcome of housing finance reform, or as a step toward recap and release. FHFA's actions would be taken solely to avoid a draw during conservatorship."

Switching to the second topic, Watt said that both during the crisis and as long as FHFA remains conservator it has **statutory mandates** to manage the GSE's day to day operations with an obligation to:

- Conserve and preserve the assets of the GSE's;
- Ensure they provide meaningful assistance to the millions of borrowers who struggled to save their homes; and
- Oversee the prudential operations of the GSEs and ensure that they continue to carry out their statutory missions in a safe and sound manner; fostering liquid, efficient, competitive, and resilient national housing finance markets in a manner that is consistent with the public interest.

The agency knows better than anyone, he said, that the status quo is not sustainable and that housing reform will involve **many tough decisions,** going well beyond the reforms that have been made in conservatorship. It is the role of Congress, not the FHFA, to make the tough decisions that will lead to the future of the housing finance system. These decisions include:

- How much backing, if any, should the federal government provide and in what form?
- How will the transition to a new system evolve while minimizing disruption; who should lead or implement that transition?
- What roles, if any, should the GSEs play in a new system and what changes will be required to their structure, purposes, ownership, and operations?
- What regulatory and supervisory structure and authorities will be needed in a reformed system and who will have responsibility to exercise those authorities?

Watt reminded the senators that September 6 will mark the beginning of the 10th year of GSE conservatorship. He called the conservatorships "unprecedented in scope, complexity, and duration," but stressed again that they are "not sustainable and need to end as soon as Congress can chart the way forward on housing finance reform. He noted, however that the ten years has led to numerous reforms that have been extremely beneficial to the housing finance markets and have reduced exposure and risks to taxpayers and that the Committee will have the responsibility to ensure that the reforms are not disregarded. Among the many he noted:

1. **Board leadership and management:** FHFA replaced most board members and many senior managers and required the GSEs to make numerous changes to improve risk management, update systems, prioritize data security and management. It has also prohibited activities such as lobbying.
2. **Alignment of certain Enterprise activities:** Rather than allow the GSEs to compete in a race to the bottom, FHFA has aligned many practices and policies to eliminate unproductive competition, while encouraging each GSE to innovate

ways to make housing finance more efficient, liquid, and consumer friendly.

3. **Sound underwriting practices:** The GSEs are required to emphasize sound underwriting practices to facilitate responsible access to credit and sustainable homeownership for creditworthy borrowers. The serious delinquency rate on single-family loans is at its lowest level since May 2008.
4. **Smaller portfolios for core business purposes:** The retained portfolios of the GSEs have been reduced over sixty percent since 2009 and both Enterprises are ahead of schedule to meet the 2018 maximum portfolio limits established in the PSPAs. Their retained portfolios are now focused on supporting core business operations, including aggregation of loans from small lenders to facilitate securitizations and holding delinquent loans in portfolio so investors can be made whole, servicers can facilitate loan modifications, and borrowers can stay in their homes whenever possible.
5. **New single-family credit risk transfer programs share credit risk with private investors:**
6. **New securitization infrastructure:** The new Common Securitization Platform (CSP) is now operating and all of Freddie Mac's existing single-family, fixed-rate securitizations are being processed using the platform.
7. **Level playing field for lenders of all sizes:** Volume-based discounts for larger lenders have been eliminated, leveling the playing field for lenders of all sizes.

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