How FHFA Is Reforming Housing Finance Now

By Buzz Roberts, NAAHL President and CEO

With Congress unlikely to tackle GSE reform before 2017, the Federal Housing Finance Agency (FHFA) has been taking several steps down its own a path to reform now. Considered together, they are hugely important both now and for the future.

The current FHFA Director, Mel Watt, initiated some of these actions and extended, expanded or reversed some policies of his predecessor, Ed DeMarco. Some are elements that would be part of any future system but do not require legislation. Others are experiments that will inform Congressional decisions. Several of the changes are inter-related.

Guarantee Fees and LLPAs

FHFA recently decided to make only relatively minor adjustments to the guarantee fees (G-fees) that Fannie Mae and Freddie Mac charge to lenders. FHFA also approved some lower loan level price adjustments (LLPAs), including for loans with high loan-to-value (LTV), which have private mortgage insurance or other credit enhancements. This means FHFA Director Mel Watt has formally reversed the G-fee increase that DeMarco announced shortly before leaving office and that Watt froze immediately after taking office.

- FHFA raised the G-fees substantially and established the LLPAs under the GSEs' conservatorship in order to: reduce the indirect Federal subsidy; generate revenue necessary to keep the GSEs solvent and make payments to the Treasury, which purchased the preferred stock to keep the GSEs afloat and maintain liquidity for mortgage securities; attract private capital (e.g., through risk-sharing structures described below); and create a pricing environment in which private label securities (PLS) could be competitive. Most analysts agree that current G-fees are sufficient for these purposes. In addition, the slow PLS market recovery for jumbo mortgages -- a segment where the GSEs do not play -- indicates that the GSEs' G-fees are not blocking a revival of PLS.

- **Caveat:** Some consumer and industry advocates wanted a substantial G-fee reduction to make GSE pricing more competitive with the Federal Housing Administration (FHA).

Risk Sharing . . .

A primary criticism of the GSE model is that it privatized profits but socialized risks (through an implicit government guarantee). Reducing taxpayer risk is a high priority in both the short term (since the Federal government currently bears virtually the entire risk of the GSEs) and the long-term (when the government would accept only "remote" or "catastrophic" risk at most). FHFA and the GSEs are pursuing risk-sharing structures for both individual mortgages and pools of mortgages.

. . . on mortgage pools. Fannie Mae and Freddie Mac have been undertaking a series of transactions in which private investors take a significant portion of the credit risk associated with large specified "reference pools" of mortgages. The market response has been good, and the GSEs have been refining their deal structures over time. Recent and planned transactions include mortgages with LTVs up to 97%. These deals reduce the government's back-stop risk today and in the intermediate future. They will also probe the market's depth and perception of risk and inform longer-term policy choices.

- **Caveat**: While today's low-risk environment is great for testing new approaches, it's hard to know how these would fare in more adverse times. A stable system needs to work in all phases of a market cycle.

. . . and on individual loans. The GSEs recently established higher capital requirements and master insurance policy standards governing the private mortgage insurers (PMIs). PMIs have long been important to first-time homebuyer mortgages because the GSEs' charters require credit enhancement for mortgage amount above 80% LTV. But the PMIs were thinly capitalized and the mortgage crisis wounded or killed them all. The surviving PMIs have recovered and new PMIs have emerged to the point where PMI mortgage originations once again exceed FHA originations. The newly announced PMI standards should help foster market confidence and stability.

- **Caveat:** The PMIs might raise their premiums somewhat to support the increased capital they must maintain, but the new reduction in LLPAs would provide at least some offset. Exactly where the all-in cost to high-LTV borrowers will settle is uncertain and important, especially relative to all-in FHA costs.

Credit Scoring

FHFA has directed the GSEs to explore credit scoring alternatives. The GSEs currently use an outdated version of FICO's mortgage score, which critics argue makes it hard for mortgage applicants with thin credit files to qualify for mortgages. Using the Vantage Score or even updated FICO scoring models could improve inclusiveness and accuracy

- **Caveat:** Although millions more consumers might become score-able, it's not clear how many would qualify for mortgages.

New Securitization Platform

The GSEs' current platforms for issuing and administering MBS are proprietary, old, and brittle. The GSEs have formed a joint venture to build a new, common securitization platform for their use in the intermediate future, and eventually for other MBS issuers that could compete with the GSEs.

- **Caveat:** This is a long and technically challenging project. Only time will tell if the new platform will be truly accessible for other issuers, or if it will reinforce the Fannie Mae-Freddie Mac duopoly.

Single Security Structure

Fannie Mae's securities are currently far more liquid than Freddie Mac's, a dangerous imbalance reflected in differential pricing that is manageable for now only because the Federal government currently sweeps all the GSEs' profits. So Fannie Mae and Freddie Mac are now developing a single security to restore equilibrium. It is intended to operate on the new securitization platform.

- **Caveat:** This project will take years to design and implement.

Multifamily Volume Limits

FHFA recently exempted loans for unsubsidized affordable rental housing from the $30 billion annual cap on each GSE's multifamily volume. The exemption applies to units affordable to renters earning up to 60-100% of area median income (AMI), depending on local market housing costs, as well as assisted living facilities affordable at 80% of AMI. FHFA retained the previously established exemptions for subsidized affordable housing, small mortgages, and manufactured housing rental communities.

- Multifamily finance volumes have increased this year, both market-wide and for the GSEs, so the exemptions will prevent the caps from squeezing out larger loans for unsubsidized affordable housing.

- **Caveat:** Because the caps were not reduced at the same time, the effect of the exemption will be to allow the GSEs to finance more high-rent housing than before.

Affordable Housing Contributions

FHFA Director Watt has ended the suspension of contributions by Fannie Mae and Freddie Mac to support the Housing Trust Fund and Capital Magnet Fund, which Congress established in 2008. Based on estimates of GSE new business in 2015, about $200 million is projected to be available early in 2016, provided the GSEs remain profitable.

Conclusion

FHFA can't do everything on its own. Other important reforms would require Congressional action and FHFA has repeatedly urged Congress to pass a GSE reform bill. But whether or not Congress acts, FHFA and the GSEs are changing the housing finance landscape now.