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Sector Comment: Proposed GSE Reforms Include Provisions for Housing Finance Agencies, a Credit Positive

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On 17 March, US Senate Banking Committee Chairman Tim Johnson (D-South Dakota) and the committee's ranking member Mike Crapo (R-Idaho) released the text of their proposed legislation to reform the housing finance system. If enacted, the proposed legislation would wind down Fannie Mae and Freddie Mac (the government-sponsored enterprises, or GSEs), replace them with a new mortgage origination platform and provide a federal guarantee for home mortgages meeting the bill's criteria.

Although passage anytime soon is uncertain, the draft is a significant milestone in defining the congressional approach to a new mortgage system if Fannie and Freddie are discontinued. Sections of the proposal are credit positive for housing finance agencies (HFAs) because they make qualified HFA mortgages eligible for the federal guarantee, allow HFAs to participate in the new mortgage platform and preserve the GSEs' multifamily lending activities. The bill provides a basis for HFAs to continue their lending program, which is their primary source of revenue for future operations and management of existing obligations.

GSEs have been important partners for state HFAs, whose primary business is financing home mortgages for low- and moderate-income buyers. Since the 2008 financial crisis, HFAs have relied increasingly on direct loan sales to GSEs and sales in the "to be announced" (TBA) market to finance single family mortgages.

If the GSEs are wound down, they would be replaced by a new federal agency, the Federal Mortgage Insurance Corporation (FMIC), which would provide an express federal guarantee for single-family mortgage losses only after private sector investors absorb at least the first 10% of the loss. The bill provides that HFA loans may be eligible for the guarantee, and it requires that other loan criteria conform as closely as possible to qualified mortgage rules recently enacted by the US Consumer Finance Protection Bureau and which favor HFA loans by exempting them from key restrictions on mortgage suitability.

The Johnson-Crapo legislation provides continued backing for existing GSE obligations during and after a wind-down, which is credit positive because it assures that existing GSE securities held by HFAs continue to have protection. The legislation provides for securitization of eligible home mortgages through a new member-owned securitization platform and includes provisions to ensure access for smaller lenders. HFAs are eligible to participate and thus can continue to securitize loans. The platform is designed to assure continued access to the TBA market. The securitization platform may adopt a tiered usage fee structure for HFAs to encourage affordable housing.

HFAs, like all lenders, would face a considerable challenge in creating new financing structures to provide for the top-loss private capital and meet the requirements of the new system, which will increase financing costs and risks posing barriers to serving moderate-income buyers. The provisions in the draft legislation that expressly recognize the role of HFAs provide a framework for their continued role as providers of affordable housing finance in a post-GSE world.

For multifamily financing, the draft provides greater continuity by directing that the GSEs' multifamily business be transferred to new entities and continued, subject to specific affordability targets. This will preserve a smaller but also significant part of HFA business because GSEs provide guarantees for affordable multifamily mortgage loans meeting their underwriting criteria. Sustained multifamily business also is positive for maintaining or growing revenues.

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