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RUMINATIONS ON THE IMPACT OF GSE REFORM ON THE ROLE OF FANNIE MAE AND FREDDIE MAC IN AFFORDABLE MULTIFAMILY RENTAL HOUSING FINANCINGS*

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The Federal Housing Finance Administration (the "FHFA"), the regulator of Fannie Mae, Freddie Mac and HUD, recently announced the first steps in the current Administration's plan to privatize Fannie Mae and Freddie Mac. These two Government sponsored Enterprises ("GSE's") recently and currently account for about 44% of all single family mortgage originations in the United States. Single family mortgage loan organizations in the United States in 2017 were about $1.75 trillion. The Mortgage Bankers Association (the "MBA") has estimated that multifamily lending rose 6% to $359 billion in 2019 and will rise another 8.6% to $390 billion in 2020. Thus the market for multifamily loans is about one fifth the size of the single family mortgage loan market.

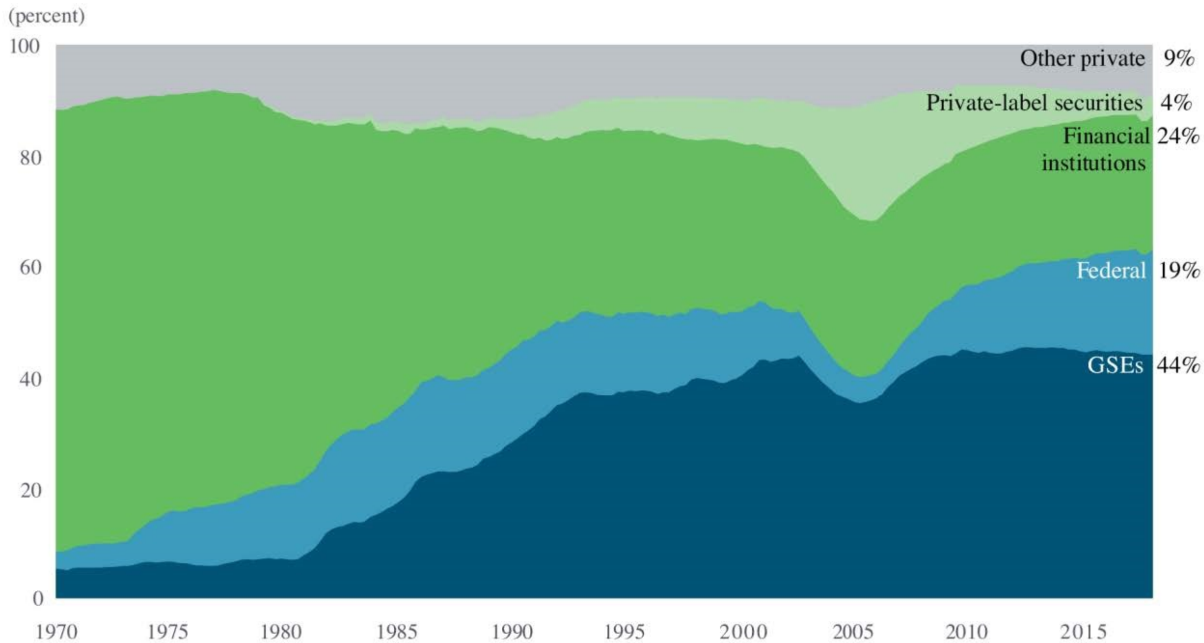
The pooled mortgage securities issued by the GSEs currently carry the backing of the US government. The Treasury Department and FHFA have indicated that they want to shrink the GSEs' role to allow more private capital to flow into the US mortgage markets; allow them to retain earnings for a year and a half to two years - $25 billion in the case of Fannie Mae and $20 billion in the case of Freddie Mac (in addition to the $3 billion they each presently hold), and deleverage their operations. Mark Calabria, the new Executive Director of FHFA, has said on a September 16 Bloomberg webcast that Fannie Mae's leverage is over 1,000 to 1. They obviously need to shrink that to be viable players once they are no longer backed by the full faith and credit of the US Government. The current proposal is that the Federal Government will make its guaranty available to them once they have been privatized, for a fee. A big question is can private mortgage purchases and private securitization come in and take up some of this slack if the roles of Fannie Mae and Freddie Mac are shrunk during this process and whether the current models for risk-sharing by Fannie Mae and for credit risk transfer through Freddie Mac securitization will be viable once the GSEs are privatized.

 While the author is solely responsible for the content of this article, he appreciates and acknowledges the assistance of his NGO colleague, Kim Griffith, Esq. in its preparation. Mr. Griffith was Vice President of Affordable Sales and Investments in Freddie Mac's Multifamily Division from 2003 to 2015 before joining NGO.

Single Family Mortgage Loan Originations

The following chart is reprinted from the U.S. Department of the Treasury Housing Reform Plan issued in September 2019 (the "Treasury Release"). It gives a historical overview for the period from 1970 through 2017 of single family loans outstanding by mortgage holder, including private label and other private securitizations, loans held by financial institutions, federal mortgage loans (including FHA insured loans held by GNMA and loans held by the Federal Home Loan Banks), and loans held by Fannie Mae and Freddie Mac.

Single-Family Mortgage Debt Outstanding by Mortgage Holder



Note: "Other private" includes mortgage debt owned by mortgage companies, REITs, credit unions, individuals, and other entities. "Financial institutions" includes mortgage debt owned by depository institutions and insurance companies. "Federal" includes mortgage debt owned by Ginnie Mae, the FHLBanks, and other federal instrumentalities. Mortgage debt owned by a PLS trust is included in "Private-label securities," even when a GSE owned a portion of the PLS. The holder of mortgage debt is not always the bearer of the underlying credit risk. There have been no adjustments to the data, for example, to reflect financial institutions' ownership of FHA or other Government-insured loans, the GSEs' ownership of PLS, or the GSEs' credit risk transfer transactions.
Source: Federal Reserve, Mortgage Debt Outstanding.

As one can quickly see from scanning this chart, the GSE holdings of single family loans have risen from only 4% or 5% in the period from 1970-1980, to about 44% in 2003, where they currently stand after dipping slightly during the 2008 financial crisis.

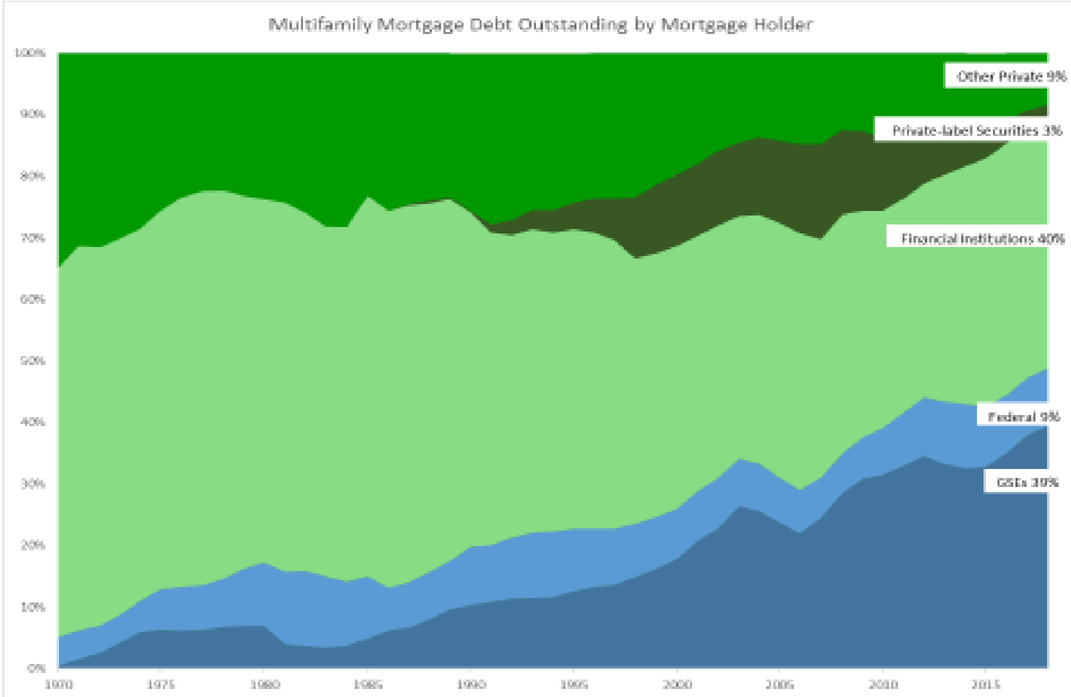
There does now seem to be a bipartisan consensus that Fannie Mae and Freddie Mac should be preserved, but downsized and privatized. To those who value the vital role the GSEs have played for decades in making low interest rate, long-term, level amortization mortgage loans, that in the case of single family loans can be prepaid at any time without penalty, available to both single family and multifamily borrowers in the United States, this is a far better result than the cries to dismantle these two vital quasi-governmental enterprises which followed their losses in the 2008 financial crisis. The losses suffered by the GSEs in the financial crisis - $119.8 billion for Fannie Mae and $71.6 billion for Freddie Mac, for a total of $191.4 billion - were indeed huge, headline grabbing dollar amounts. However, for those who bothered to do the math, these losses were dramatically lower as a percentage of their exposure than the losses incurred by banks, investment banks, mortgage companies and other single family lenders. Moreover, since the financial crisis, the GSEs have sent a combined $300 billion in dividends back to the U.S. Treasury.

It is probably impossible for anyone to predict at this time how this restructuring of the GSEs will evolve, but it is clear that the recent assessments by the US Treasury Department and FHFA are only the first steps and that the process of restructuring the GSE's will take years and will continue to evolve as it moves forward. For example, if Fannie Mae is presently leveraged at 1,000:1 with $3 billion of capital, raising that to $28 billion will bring the leverage down to 107:1 - still far above the level it will need to achieve to become a viable independent financial institution.

It would not seem unreasonable to project that mortgage rates will have to rise, perhaps substantially, over where they otherwise would be in order to bring this kind of private capital back in and/or to pay the Federal Government a guaranty fee for guaranteeing Fannie Mae and Freddie Mac mortgage securitization certificates, as has now been proposed by the Treasury Department and FHFA. The restructuring of the GSEs to permit sufficient capital retention and capital raising is necessary to move beyond the "temporary" current conservatorship. Market participants appear to have concluded that an explicit government guaranty paid for by the GSEs is needed in order for the private market to buy mortgage securities backed by fixed rate, long term fully amortizing, pre-payable without penalty, single family mortgages with reasonable leverage. With adequate retained capital and sufficient new capital raised, one can reasonably project that the transition of the GSEs from their current relationship with Treasury to a private highly regulated structure can be achieved without major housing market or economic disruptions.

Multifamily Mortgage Loan Originations

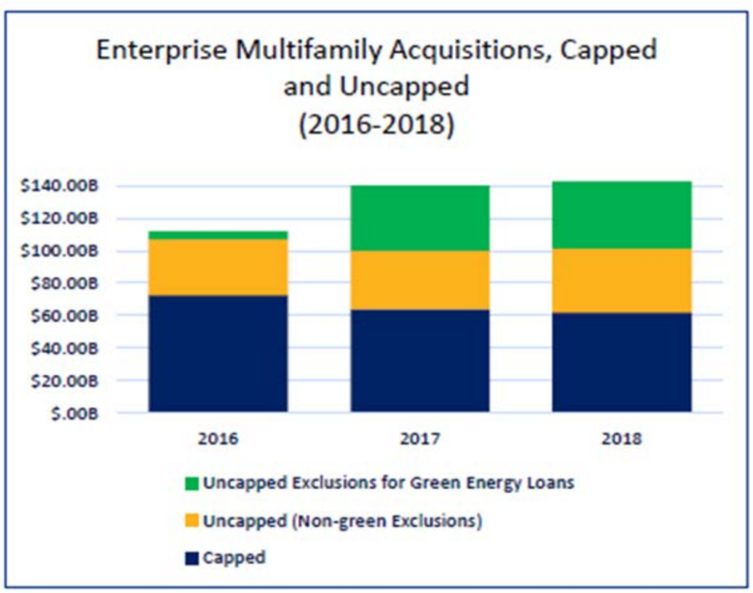
The following chart is from the FHFA's September 13, 2019 Release: FHFA Revises Multifamily Loan Purchase Caps for Fannie Mae and Freddie Mac (the "FHFA GSE Release"). This chart focuses on the percentage of all **multifamily** debt outstanding by each major category, including the GSEs' from 1970 through 2019. As can be seen from the dark blue shaded portion at the bottom of this chart, the GSEs' percentage of outstanding multifamily mortgage loan debt has expanded dramatically from about 25% at the time of the financial crisis in 2008 to about 39% today.



Note: "Other Private" includes mortgage debt owned by mortgage companies, REITs, credit unions, individuals, and other entities. "Financial Institutions" includes mortgage debt owned by depository institutions and insurance companies. "Federal" includes mortgage debt owned by Ginnie Mae, the Federal Home Loan Banks, and other federal instrumentalities. Mortgage debt owned by a PLS trust is included in "Private-label securities." (Source: Federal Reserve, Mortgage Debt Outstanding)

Federal Housing Finance Agency. (2019, September 13). FHFA Revises Multifamily Loan Purchase Caps for Fannie Mae and Freddie Mac [News Release]. Retrieved from https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Revises-Multifamily-Loan-Purchase-Caps--for-Fannie-Mae-and-Freddie-Mac.aspx

The GSEs combined originations for 2017 and 2018, were approximately $140 billion per year (about $70 billion each) as shown in the chart from the FHFA GSE Release below.



Note: This reflects loans that qualify in more than one category, and therefore the total numbers are greater than actual Enterprise multifamily loan purchase totals in each category and overall. (Source: FHFA Conservatorship Scorecard Progress Reports, 2016-2018)

Federal Housing Finance Agency. (2019, September 13). FHFA Revises Multifamily Loan Purchase Caps for Fannie Mae and Freddie Mac [News Release]. Retrieved from https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Revises-Multifamily-Loan-Purchase-Caps--for-Fannie-Mae-and-Freddie-Mac.aspx

Both Freddie Mac and Fannie Mae very recently raised their spreads by about 40 basis points or so due to recent concerns expressed by FHFA that their multifamily portfolios were growing too rapidly in 2019. In the FHFA GSE Release, FHFA announced that for the last calendar quarter of 2019 and the four calendar quarters of 2020, their annual volume will be capped at $80 billion each. If the GSE multifamily loans had grown at the Mortgage Banker's 6% 2019 estimated rate, their annual volume would have been about $74.2 billion each; or a quarterly rate of $18.55 billion, at the time of the FHFA GSE Release.

Let's assume GSE multifamily originations had not been capped and over the last quarter of 2019 and the four quarters of 2020, they grew at the MBA's estimated 8.6% rate for multifamily loans over these five quarters. Each GSE's originations could be roughly as shown in the chart below.

September 2019	Est. Quarterly Volume ($ Bil.)	Quarterly Cap	Room Before Cap Reached/Annual Volume Loss Due to Cap. ($ Bil.)
Q4 2019	$18.55	$20 Bil.	1.45
Q1 2020	$18.9	$20 Bil.	1.1
Q2 2020	$19.4	$20 Bil.	0.6
Q3 2020	$20.2	$20 Bil.	(0.2)
Q4 2020	$20.6	$20 Bil.	(0.4)

Note the Cap is not quarterly; it's an annual cap of $80 billion per GSE. But what the above calculations seem to suggest is that the $80 billion per GSE cap on multifamily origination has been designed to allow the GSEs to grow their multifamily originations during the next five quarters at more or less the projected grown in multifamily loan originations, but not more. Life could be a lot worse!!!

It is important to note that, the former "uncapped" subcategories: (i) "green energy loans" and (ii) very broadly "affordable" or other special loan categories (e.g. small loans, manufactured housing, senior loans), each of which had represented about ¼ of total volume in 2017 and 2018 as shown in the above chart (the green and yellow bars), will no longer be uncapped – everything must fit within the total.

While it appears the Treasury and FHFA will generally limit further growth in overall multifamily originations to the projected growth in the market, at least 37.5% of the total permitted GSE multifamily volume will now be required to be affordable or other "mission driven" loans – the "green" category has been eliminated. This could encourage even greater emphasis on affordable volume, which could result in GSE spreads on affordable multifamily loan relaxing a bit in the coming calendar year.

It seems difficult at this time to predict exactly how these factors will play out and what impact they will have on affordable multifamily rental lending volume and spreads and terms. However, one would expect that as the restructuring of the GSEs continues, they will continue to play a restrained, but nonetheless major role in affordable multifamily rental housing bond finance in the months and years ahead.