GSE Activity Report

Friday, May 1, 2020

Curtains for CRT?

Summary

As we noted yesterday, Freddie Mac's 1Q earnings statement included doubts about CRT's long-term viability. Fannie today is less gloomy but has nonetheless shuttered back-end CRT for as long as the financial markets remain inhospitable. We had expected both GSEs to take this prudent course, but the necessity for each to do so makes it still more clear that CRT's future under even benign market conditions is wholly uncertain.

Impact

Fannie's statement reiterates that changes to CRT adversely affect its ability to meet current capital standards. It is not, though, keeping on as usual in the midst of the CRT shut-down and, doubtless, the added capital pressure of FHFA's decision to conform its servicing support to Freddie's four-month standard, new authority to buy loans in forbearance, and all the risk building up in the single- and multi-family sectors. In the absence of CRT, Fannie signals that it may reduce the amount or type of mortgages it purchases, a warning shot to the market that Fannie could well realign standards to target capital-efficient mortgages or those still possible under limited front-end authority. Notably, Fannie today disclosed that FHFA told it in March to terminate front-end lender deals by year-end; Freddie provides no comparable notice in its 1Q.

Outlook

As we concluded yesterday, CRT's problems now lay bare the risks inherent in its initial, procyclical construct. All CRT structures are procyclical to some extent because virtually all credit enhancers will draw back in stressed market conditions. It is for this reason that we have long doubted the viability of a post-conservatorship model intended as both a conduit for CRT into the capital market and a through-the-cycle mortgage utility. However, the GSEs' longstanding CRT products are even more procyclical than most because of reliance on capital-market counterparties without resilient capital or liquidity buffers with numerous other business objectives. With this now apparent, the embedded contradiction between private capital and public purpose cannot be ignored in future post-conservatorship business models. These will, as we also noted, come more slowly due to still more GSE capital stress setting back any hope of IPOs any time soon even if markets recover quickly enough to be willing to consider them.

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com