GSE Activity Report

Thursday, May 24, 2018

Having None of the New

Summary

In our report yesterday, we assessed a critical take-away from Senate Banking's hearing: the shape of new GSE capital regulation. Today, we turn to a nearer-term question: the fate of many controversial new programs Fannie and Freddie have offered without undertaking the public notice-and-comment many think mandated by the 2008 reform law. Mel Watt yesterday made it clear that he's fine with innovation without notification, but we doubt the industry will let matters rest there.

Impact

What was on Senate Banking's hit list?

- GSEs' purchase of loans with less than five percent down and expanding their 97 percent LTV loans;
- Freddie's HomeOne, separate from its existing low down payment program, will allow low down payment loans without any income or geographic restrictions;
- Freddie "supercharging" its 3 percent down program;
- GSE pilot programs that allow certain lenders to sell loans with 1 percent, or even 0 percent, down;
- Fannie Mae raising its maximum debt-to-income ratio to 50 percent;
- Fannie and Freddie expansion into other markets, such as single family rentals and multi-family;
- Freddie lines of credit to nonbank mortgage servicers, presumably at cheaper rates than available in the market;
- Fannie Mae AirBnb "financing";
- Fannie's funding of Invitation Homes; and
- Freddie's IMAGIN program, criticized for disrupting the mortgage insurance market.

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Several of these programs were also sanctioned by House FinServ Members when FHFA's IG came to testify, but she was not called to account. When Watt was, he said that asking for public notice and comment would simply slow down useful innovation. With regard to the Invitation loan, he did indicate that the GSEs would purchase no direct loans provided to rent-to-own borrowers with FHFA approval, but the other programs were clearly good to go.

Outlook

Does the law sanction all this innovation? You be the judge, but we read Section 1123 of HERA (12 U.S.C. 4541 et seq.) to say that new programs not only require FHFA approval, but also a comment period before a product is offered. The only exceptions are modest changes to the AU system or to purchase criteria that do not alter underlying transactions. "Substantially similar" activities to pre-2008 offerings are also given an out, but loans for new purposes – e.g., warehousing – or to new corporate entities – e.g., Invitation – or insurance in wholly new structures – IMAGIN – do not seem to us to meet these criteria.

Will Congress do more than complain? We doubt it. Will competitors litigate? That's hard since it's FHFA, not the GSEs, at fault. Mission creep or not, these programs and perhaps other new ones appear to be facets of the fast-changing mortgage-finance system.

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