Federal Financial Analytics, Inc.

MORTGAGE MAYHEM

In 2021, the U.S. residential-mortgage market faces a witches' brew: new federal policy for the GSEs and FHA, rising market risk, and the COVID-forbearance unwind. A new housing-finance policy construct will ensue whether by Biden-Administration design or the default resulting from inexorable macroeconomic stress.

The *Wall Street Journal's* interview today with Treasury Secretary Mnuchin seemed to settle it: the GSEs' conservatorship will continue into the Biden Administration. That isn't, though, the same as saying that what mortgage finance is now will be what mortgage finance remains under Joe Biden.

Karen Petrou's December 11 client memo laid out an array of reasons to worry about long-term mortgage-market stability, contradicting the Fed's sanguine forecast and FSOC's calming word. As the data she provided demonstrate, the home-equity buffers on which the Fed and FSOC count for market resilience adhere to only about one-third of U.S. households – and that percentage predates the refi and home-purchase booms that over the past two quarters have sharply eaten into prior home-equity totals. Significant differences in the cost of home ownership and thus its risk for minority households also argue for caution, caution we expect to see quickly reflected in Biden Administration action not only on mortgage regulation, but also the future of Fannie Mae, Freddie Mac, and the Federal Housing Administration.

FedFin took its first look at forward-looking policy in an analysis of Janet Yellen's thinking as she takes over Treasury's Financial Stability Oversight Council. Much here of course depends on what structural decisions the Trump Administration makes before inauguration. While Mr. Mnuchin foreswore privatization, he did not similarly preclude structural change. As a result, the GSEs' charters could be constrained in ways the Biden Administration will leave untouched even if they take the challenging actions necessary quickly to unseat the powerful, independent head of the Federal Housing Finance Agency.

However, the Biden Administration will likely go farther. Systemic designation for the GSEs squares the circle by turning the GSEs into the equivalent of federal utilities, retaining tough capital standards, and adding the resolution, stress-testing, and liquidity requirements long advocated by the Fed. The Dodd-Frank Act also gives FSOC the authority to mandate new racial-equity standards for the GSEs and we look for these atop stiffened affordable-housing restrictions.

And, of course, there's the systemic standards set to come also for nonbank mortgage firms. At present, FSOC and FHFA count on massive earnings inflows due to the 2020 mortgage boom to provide nonbank servicers with the cushion needed to handle advances when forbearance ends and losses emerge across the spectrum of higher-risk borrowers with slim home-equity cushions. The Fed doesn't buy this and we doubt the new FSOC under Secretary

Yellen will either. The sooner the vaccine-driven recovery, the less the risk; the slower, the longer, but it is clear that, any way one looks at it, 2021 will redefine the U.S. secondary mortgage market and who wins or loses thereby.

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