GSE Activity Report

Thursday, February 25, 2021

Money for Something, Housing for Free

Summary

In a new paper, Lew Ranieri, who needs no introduction, and Mike Calhoun of the Center for Responsible Lending float an important new idea along the way to turning the GSEs into the utilities presaged by actions under the Trump Administration to recast the conservatorship. Noting precedents for Treasury recapture of warrants in prior financial rescues, the paper estimates that the USG's position in the GSEs amounts to as much as about $100 billion, creating a kitty from which significant new affordable-housing and racial-equity initiatives can be funded. Given the long odds of substantive Congressional action and Democratic control, this option may be darn tempting even though the paper's construct poses some policy, operational, and structure challenges – not to mention a few thorny political ones.

Impact

The case studies cited in this stimulating paper are AIG, GM, and Chrysler, all of which were backed with TARP funds during the 2008 great financial crisis. The law allowing this, TARP, gave Treasury express authority over its assistance and how to wind it down. When the Treasury came to step back from these companies, it waived and relinquished assets, leading to net losses of about $30 billion. The GSEs' rescue in 2008 was under the law specific to the GSEs but Treasury likely has authority not only to hold the warrants it took during the rescue, but also to restructure them via contractual changes in the PSPA if desired.

The paper points out that – in sharp contrast to AIG, GM, and Chrysler – Treasury can use its holdings for an express housing-policy goal because affordable housing is an explicit requirement of the GSEs' charters. It argues that Fannie and Freddie need also to be forced to assist racial equity, stating that Fannie's purchases of African-American mortgages was only 4.8% and Freddie's only 3.6% -- numbers that, if correct, will surely lead to hard questioning from senior Congressional Democrats and Treasury.

One critical obstacle to ending the conservatorship cited by Secretary Mnuchin when he gave it up was the difficulty valuing these warrants when held outside conservatorship to ensure that taxpayers get a fair deal. Advocates have suggested that the $191 billion or so Treasury earned above its GSE supports was compensation enough, but Treasury and many Members of Congress disagreed. Were Treasury now to proceed as this paper recommends, Treasury warrants would be relinquished in return for fiscal benefit in terms of improved housing and equity – not hard dollars. This could well make it easier for Treasury to step back. Although the $191 billion is also at issue in litigation heading to the Supreme Court later this spring, this may prove an incentive for the Biden Administration to make as much use of it now as possible even though the odds of investor recapture seem small.

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The paper also asserts that waiving warrants for a new purpose would not result in a net loss to the Treasury since the USG has already made money on the GSEs' rescue. However, this approach to long-term finance is not exactly how federal budgeting works. As a result, that which goes out of warrants into a GSE fund could be costly when scored by either OMB or CBO unless the GSEs themselves are put on budget as CBO and others have long advocated.

Assuming the budget question is surmounted, the paper's operational details are intriguing. It suggests an independent, joint affordable housing entity akin to Common Securitization Solutions. FHFA would oversee the entity housing Treasury's warrants and, perhaps, an equivalent amount of GSE stock, cash, or other assets. Where these funds sit and how they affect regulatory capital is a critical detail left unaddressed – moving stock out of the GSEs reduces capital while transferring assets could raise it, at least for leverage purposes.

Surely adding to advocacy-group support for the plan, this new affordable-housing entity would not undertake direct action but instead fund third-parties to do so. This was in fact the approach proposed in 2008, but it led to vociferous GOP protests that federal funds would back groups such as ACORN and others excoriated at the time for political advocacy. Programs specified in the new affordable-housing facility would include a "Restorative Justice Fund" for Black and other ill-treated homeowners to fund downpayments and other steps to sustainable home ownership, along with actions to increase housing supply, end LLPAs, increase low-downpayment purchases, and increase home-ownership outreach. The paper also argues that a utility construct for the GSEs will permit lower g-fees due to reduce return objectives, but this appears to be a broader point about GSE restructuring rather than one pertinent to the new affordability joint venture.

Outlook

This points to an area in which the paper is less clear: whether the new joint affordability facility is the goal of reform or if this is only part of a broader utility rewrite akin to that proposed earlier this year by a group funded by the National Association of Realtors. Redirecting Treasury warrants into a new facility will not on its own reconstitute Fannie and Freddie into utilities with a still broader public purpose, but it might well be a step along the way.

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