# GSE Activity Report

Tuesday, March 2, 2021

## Pop Goes the PSPA?

### Summary

Critics of FHFA policy are finding still more affordable-housing ammunition to add to their anti-PSPA armament. A new Urban Institute paper takes aim at the revisions to the agreement struck at the last minute in January by Steven Mnuchin and Mark Calabria, honing in on restrictions on higher-risk, second, and investor mortgages in ways sure also to delight key industry groups hoping to get this business back.

### Impact

Key to the Urban Institute study is an assessment of how the new limits on higher-risk mortgages comport with existing exposures, marshalling data to demonstrate that the new limits will indeed be biting for periods of time. The paper points out that these exposures also carry capital costs over four times that of low-risk loans, arguing that the new ceilings are thus not only punitive to low/mod and minority households, but also unnecessary. The paper concedes that many of these borrowers would simply opt for FHA loans, but views this as only a risk shift from one taxpayer pocket to another that is also ill-advised. The Treasury/FHFA rationale for doing so – differencing the GSEs' mission from FHA's – is not acknowledged. The paper also asserts that high-risk restrictions will reduce the GSEs' ability to support loan mods after forbearance ends since more loans are sure to shift into these constrained high-risk categories.

As the paper notes, second liens and investor loans also come under new ceilings unrelated to risk given the relatively favorable risk weightings for them in the new capital rule. It's harder to argue that these loans are important to low/mod and minority borrowers, but the paper still opposes them. Noting that investor loans are the GSEs' "cash cows," it concludes that limits here undermine mortgage price cross-subsidies essential to affordable mortgage rates for higher-risk borrowers.

For good measure, the paper adds that all these constrains impede monetary-policy transmission by reducing housing access and the value of refis in transmitting lower interest rates.

### Outlook

We expect Democrats to be sympathetic to these arguments because of their innate antipathy to anything the Trump Administration and FHFA did about Fannie and Freddie. However, FHFA defended its back yesterday by doubling the GSEs' affordable-housing contribution and will have other mission defenses and potential concessions readily at hand should need arise.

These include the mission defense noted above for HLTV loans, the fact that many high DTI

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borrowers were taking out loans for temporary rentals, and the ready ability of FHFA to alter limits if needed for post-forbearance loan mods. Pricing cross-subsidization is a tricky game given the role LLPAs play in the pricing equation and we think FHFA may well hold its own on this front as well.

Given the low odds of legislation, the most important audience for these discussions is Treasury. Sympathetic though Janet Yellen will be to some of the arguments in the Urban Institute paper, we think she will also be very responsive to FHFA rebuttals along the lines noted above. The PSPA may well change to provide more scope for low/mod and minority loans and, in doing so, move at least some of the PSPA's celling, but the most important battle is not over the limits, but the GSEs' structure itself. Here, as noted, we think Treasury will cotton to a new utility construct embodied in regulations implementing the systemic designations to which FSOC will turn when time permits.

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