GSE Activity Report

Wednesday, September 15, 2021

GSEs Get a New, If Familiar, Gig

Summary

As noted yesterday, Treasury and the FHFA pulled the Trump PSPA's plug, although importantly and widely overlooked is that this is true only when it comes to near-term asset-purchase considerations. Still, with this action atop all the others redefining Fannie and Freddie since Sandra Thompson took over, the GSEs are being reconfigured into agents of Administration policy in concert with being still more critical agencies for housing finance.

Impact

When the Biden Administration took over, we forecast a PSPA rewrite, but we didn't at that point foretell what might come of it if the Supreme Court allowed the White House also to force out the Trump Administration's FHFA pick. We knew the PSPA rewrite would be consequential, but – once it's finalized – the Biden PSPA construct will also be a game-changing first for the market and then for the future of the conservatorships.

The new PSPA is now clearly based on the recent Presidential executive order prioritizing affordable housing. Treasury's PSPA release emphasizes not only the White House's focus on affordable housing, but also its own concerns about what some consider a housing-price bubble. FHFA's release confined itself to matters largely at hand in the PSPA, but importantly also says that Mark Calabria's controversial capital construct is under rapid review. If it holds – and it likely will – this new game will be one very much to the mortgage-banking industry's liking. Key PSPA provisions now on the chopping block are:

- high-risk mortgage restrictions. A raft of restrictions on purchase and refi loans related to LTVs, DTIs, and scores are now on hold;
- multi-family purchase caps and "mission-driven" restrictions;
- constraints on second mortgages and investment properties; and
- changes to the small-bank cash window.

Left in place are small-bank protections aimed at ensuring equitable g-fees and – an important nod to longstanding Fed concern – portfolio constraints. Indeed, the Fed directly and as Yellen channels it will be influential as Treasury and FHFA press on. FHFA signals it will now consult Treasury as it finalizes prudential standards and Treasury will surely check in with the Fed.

Nowhere will this be more important than in the new capital construct cobbled from the Calabria capital rule. An almost-certain set of capital revisions will come for credit-risk transfer, making at least some of the changes sought by both the GSEs and structured-finance industry at least in terms of new risk-share opportunities. Whether these will finally allow front-end CRT, be limited to affordable-housing related risk, or simply let the GSEs get about more rapid recapitalization thanks to CRT remains to be seen.

Even more likely than CRT changes are additional revisions to give the GSEs a capital break for affordable-housing loans. Given the White House's focus on manufactured housing, we think the risk-based rules will give the GSEs more of a break in this sector. FHFA is likely also to take another look at its decision to retain both an advanced and standardized approach (SA). Doing so would not only simplify the GSEs' rules as many commenters recommended, but also reflect the direction banking agencies are soon to take. It would also allow cross-subsidization within SA categories that expands affordable-housing capacity without undue capital cost.

Will FHFA go farther and make changes such as revising key capital components or sharply reducing the role of the leverage ratio? These calls are solely within its remit, but Treasury will not like any capital rule that goes too far astray from the construct favored by the Fed for the biggest banks and we doubt FHFA will beg to differ. One way to square all these competing demands would be just to scrap the rule and create a GSE equivalent of the big-bank stress capital buffer, but this would take a long, long time and is thus impossible within the timeframe FHFA set for itself on Tuesday.

Outlook

The PSPA changes end at the latest one year or six months after Treasury and FHFA set a permanent regime in place. FHFA set no firm time on its capital rewrite other than to say it will be soon.

That may actually be really soon or sort-of soon – it all depends on how FHFA wants to proceed given that the capital rule is a rule and thus subject to the Administrative Procedure Act's procedural requirements. Change could come fast via an interim final rule that seeks comment even as revisions are made or via the more lengthy notice-and-comment proposal process. With a proposal, action can still move fast if comment deadlines are short (likely no less than thirty days) and FHFA knows what it wants to do, but the odds are that final action will take time not only for FHFA to make up its mind, but also to avoid challenges on "arbitrary and capricious" grounds.

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