GSE Activity Report

Monday, January 8, 2024

Who Gives When GSEs Go

Summary

It's not news to observe that things that change at the GSEs then change a lot of other things. Still, the scope of the GSEs' influence across financial markets is startling as measured by a new Federal Reserve Bank of Philadelphia study of the spillover effect of the 2020 revisions to the PSPA. The paper looks specifically at PSPA provisions restricting GSE purchase of what the paper calls speculative mortgages (i.e., seconds and investment properties). Push here for GSE spec loans, pull there is observed for spec loans in the private sector, all other conforming loans, jumbos, and – surprisingly – bank small-business loans.

Impact

The first-order question is whether the PSPA's edict worked as intended at Fannie and Freddie. In short, it did – GSE spec purchases dropped by about 40% followed by overall market credit-supply decline and rate hikes of about a statistically-significant 13 bps. Lenders originated fewer seconds and investment mortgages because they couldn't sell them, but the amount of these loans on their balance sheets sharply increased by about 80%, reducing market impact. However, banks offset the balance-sheet risk and capital cost of these loans with reduced small-business and jumbo-mortgage exposures in markets where spec mortgages play a significant role (e.g., vacation communities). The paper's coefficients suggest that a 10 percent increase in exposure to these speculative loans leads to a decline in small business originations of approximately 0.8 percent and in jumbo mortgage originations of approximately 5.5 percent.

Notably, when the GSEs reduced their spec-loan purchases, they increased their other mortgage purchases. The magnitude of the increase in primary residence transactions during this period more than offsets the decline in speculative transactions, which the authors suggest may reflect credit becoming more available for non-speculative mortgages as lenders reallocate capital toward these borrowers secure in the knowledge that Fannie and Freddie would be even readier to buy these loans. This was the mission realignment intended by the PSPA rewrite, an interesting precursor for similar restrictions as FHFA imposes them.

Outlook

Still, what do we really know? First, the full-on 2020 restrictions on GSE spec-mortgage purchases lasted only three quarters, three quarters when mortgage rates were also super-low and the Fed was buying buckets of agency MBS. Would markets have recovered for spec loans as readily under other conditions if the GSEs again pulled out? Conversely, would the GSEs bulk up their non-spec book or conserve capital now that they're under tougher rules? Would the impact on bank small-business and jumbos be still more acute given the new capital rules if they follow the money and book more seconds and investment loans? We expect each of these altered outcomes is likely under current circumstances, but what they would be under future ones is hard to foresee.

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