ACG ANALYTICS

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Housing

What's next for Fannie and Freddie

Executive Summary: Below, ACG Analytics examines what is next for Fannie Mae and Freddie Mac and the Federal Housing Finance Agency (FHFA) following last month's Supreme Court decision in *Yellen v. Collins*.

Issue

The glaring question that has arisen following the Supreme Court decision in *Yellen v. Collins* is what is next for Fannie Mae and Freddie Mac. Specifically, there is still uncertainty as to what policy direction the Biden Administration will pursue in housing and who will be the likely Director of the Federal Housing Finance Agency (FHFA) to carry out that mandate.

Impact

The primary priority of the Biden Administration in housing will be racial equity and affordability. For example, we immediately saw calls from the Community Home Lenders Association, in a letter to Sandra Thompson, Acting FHFA Director, and Treasury Secretary Janet Yellen to lift the caps on loans imposed by the last letter agreement in January 2021. While the letter advocates raising caps on higher risk loans, investor and 2nd home loans, and lender-by-lender cash windows, there is no mention of capital needs in these missions. The Administration appears to be focused solely on affordable housing and less so on the capital structure which would support these goals.

Next Steps

Whether the expansion of equity and affordable housing is achieved by capitalizing the entities and employing a utility regulatory model, continuing the status quo and broadening the credit box, or attaining funds for affordable housing from Congress remains to be seen. Much will depend on the Director chosen as Mark Calabria's successor. We believe that the 3 primary candidates in the running at this point in time are current Acting Director Sandra Thompson, Wharton professor on real estate and finance Susan Wachter, and Mark Zandi, chief economist at Moody's Analytics. In our view, the position is Thompson's to lose.

More Information, Below

Sandra Thompson would most likely continue the safety and soundness mission of FHFA whilst simultaneously expanding credit for housing. In prepared remarks, Sandra Thompson said notably, "*Throughout my career as a financial regulator, I've said that safety and soundness and access to credit are not mutually exclusive and shouldn't even be thought of that way*." Throughout her speeches she has reiterated these pillars: responsible lending and affordability.

Susan Wachter has advocated converting the GSEs into public market utilities, a model similar to that seen in the *Brookings* paper published earlier this year by Lew Ranieri and Michael Calhoun. This too would favor both expanded credit alongside capital and lower earnings.

Given the last letter agreement stopping the net worth sweep, the Administration has 3 options pertaining to profiting from Fannie and Freddie:

1. Ignore potential pockets of money in GSE earnings and the government warrants and boost credit via looser standards;
2. Recapitalize and exercise warrants; or
3. Reinstate the net worth sweep.

The easiest thing to do is to do nothing. The Administration can continue the status quo and let capital build while using the capital buffer to engage in higher risk activities.

The next more plausible scenario is the government using the value of the warrants to fund affordable housing and create a lasting solution for the GSEs. This solution is advocated by many Progressives.

ACG Analytics views the reinstatement of the net worth sweep as an unlikely policy decision, despite the Supreme Court giving FHFA *carte blanche* to do so. It is difficult to imagine a political justification for not allowing capital to build on Fannie and Freddie's balance sheets. Additionally, with pending litigation, this could weaken the government's position in the court now that the financial crisis has all but passed.

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