Search

- Sign In
- Register

View Cart Subscribe Now

- Magazine
- REwired
- Sections
- Events
- Resources
- Knowledge
- Videos

- Magazine
- Current Issue
- Access All Issues
- Subscribe Now
- Order Back Issues

- Sections
- Lending
- Servicing
- Investments
- Real Estate
- Valuations
- People Movers
- Kudos
- Technology
- In the Money

- Events
- Industry
- Economic

- Resources
- Editors' Choice Awards
- Mortgage Services Guide

Search

- Sign In
- Register

View Cart Subscribe Now

- Subscribe Now
  - HousingWire Magazine
  - Email Newsletters

- Magazine
  - Current Issue
  - Access All Issues
  - Subscribe Now
  - Order Back Issues
- REwired
- Sections
  - Lending
  - Servicing
  - Investments
  - Real Estate

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

    - Valuations
    - People Movers
    - Kudos
    - Technology
    - In the Money
- Events
    - Industry
    - Economic
- Resources
    - Editors' Choice Awards
    - Mortgage Services Guide
- Knowledge
- Videos

RADIAN
CELEBRATING 40 YEARS
Radian Rates Mobile App
Fast. Easy. Unlimited.
Learn More

Home » Republican tax plan will trigger another Fannie, Freddie bailout
Lending In the Money

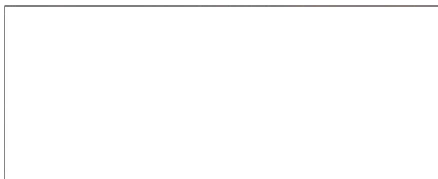
Republican tax plan will trigger another Fannie, Freddie bailout

Reduction in corporate tax rate would impact GSEs' deferred tax assets

November 2, 2017
Ben Lane
3 Comments

KEYWORDS Bailout Department of the Treasury Fannie Mae Freddie Mac Republican tax plan Tax Cuts and Jobs Act Treasury Treasury Dividends treasury draw

On Thursday, the Republicans finally released their highly anticipated tax reform plan, and as it turns out, the Tax Cuts and Jobs Act may impact the housing economy much more than first thought.



In fact, the Tax Cuts and Jobs Act could bring on a flashback to the housing crisis that many thought they'd never see again – another bailout of **Fannie Mae** and **Freddie Mac**.

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

The plan, which Republicans claim will simplify individual tax rates and cuts the mortgage interest deduction in half from $1 million to $500,000, also calls for a reduction of the country's corporate tax rate from 35% to 20%.

And if the corporate tax rate is reduced to 20%, Fannie and Freddie would both likely need another draw from the **Department of the Treasury** in the quarter that the tax plan goes into effect.

The issue is complex, but it boils down to two things: the fact that the government-sponsored enterprises will soon have zero capital and the GSEs' deferred tax assets.

Under the terms of the Preferred Stock Purchase Agreements that went into effect when the government took the GSEs into conservatorship, Fannie and Freddie send dividends to the Treasury each quarter that they are profitable.

In the third quarter, Freddie posted earnings of $4.7 billion, while Fannie made $3 billion, but under the PSPAs, the GSEs are prohibited from rebuilding capital, meaning that that $7.7 billion is headed to the Treasury.

Additionally, the PSPAs stipulate that each of the GSEs' capital base is required to be reduced over time, with their capital reserves scheduled to be drawn down to $0 on Jan. 1, 2018.

And with zero capital on hand and a reduced corporate tax rate potentially taking effect, another bailout is highly likely, if only for that quarter, an investigation by HousingWire can reveal.

Why would this happen? Fannie and Freddie's deferred tax assets.

Here is how Fannie Mae explains it in its 3rd quarter 10-Q filling with the **Securities and Exchange Commission** (*emphasis added by HousingWire*):

> *The current Administration proposes reducing the U.S. corporate income tax rate. Under applicable accounting standards, a significant reduction in the U.S. corporate income tax rate would require that we record a substantial reduction in the value of our deferred tax assets in the quarter in which the legislation is enacted.* ***Thus, if legislation significantly lowering the U.S. corporate income tax rate is enacted, we expect to incur a significant net loss and net worth deficit for the quarter in which the legislation is enacted and we could potentially incur a net loss for that year****. As noted above, if we experience a net worth deficit in a future quarter, we will be required to draw additional funds from Treasury under the senior preferred stock purchase agreement in order to avoid being placed into receivership.*

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

Basically, that means that if the corporate tax cut is passed, Fannie and Freddie likely won't have enough profits in that given quarter to cover the reduction in the value of their deferred tax assets, nor will they have any capital on hand to cover the losses.

That means Fannie and Freddie will need another draw from the Treasury, in order to make up the difference.

Here's how Freddie describes it in their SEC filing: "A reduction in corporate tax rates would require us to measure our net deferred tax asset using the new rate in the period in which the rate change is enacted, resulting in a one-time charge through the tax provision. This increase in tax expense could significantly increase the risk of a draw."

As **Fitch Ratings** noted earlier this year when broaching this very topic, the GSEs' deferred tax assets consist primarily of "deferred fees, basis differences related to derivative instruments, mortgage related assets and allowance for loan losses."

When Fitch calculated the estimated impact of a reduced tax rate in February, it based its calculations on Fannie's DTA of $35.1 billion and Freddie's DTA of $18.7 billion.

Under that scenario, if the corporate tax rate is cut from 35% to 20%, Fannie would write down its DTA by $15 billion, while Freddie would write down its DTA by $8 billion.

However, each of the GSEs current DTA is less than it was in February. A review of each of the GSEs' 3rd quarter earnings materials shows that Fannie's DTA is currently $30.45 billion, while Freddie's DTA is $14.58 billion.

So the write down would be less than Fitch originally projected, but the likelihood of Fannie and Freddie needing another bailout would significantly increase under the Republican tax proposal because each of the GSEs' profit in the given quarter is likely to be less than the write down amount.

And taxpayers would be left covering that difference.

Now, as Fitch also noted, Fannie and Freddie each have additional funding available to them under the PSPAs that would likely cover the needed draw.

As Jim Vogel, fixed income strategist at **FTN Financial** told HousingWire, the one-time tax hit and subsequent draw would likely be counteracted by future profitable quarters for the GSEs, which would also benefit from the lower future tax rate.

And as Fannie noted Thursday, it "expects to remain profitable" for the foreseeable future.

"It will lead to a draw as deferred tax assets are reduced in value, if for no other reason the entire change is recognized in one quarter and any quarter's results can trigger the Treasury backstop," Vogel told HousingWire. "Then, dividend flows will gradually 'pay back' the draw to Treasury as net income rises based on the lower rate. In economic terms, taxpayers will see little net difference due to their backstop of the GSEs in conservatorship."

So, with another bailout now looming, will Congress or the **Federal Housing Finance Agency** act to either allow the GSEs to retain some capital or truly pursue housing finance reform? The clock just started ticking.

VIDEO FROM HOUSINGWIRE & OUR PARTNERS

Docutech and Simplifile collaborate to provide seamless eClosing solution

The combination of Docutech's dynamic document generation engine, eSign and eClosing technologies with Simplifile's eRecording a…

00:00 01:54

Reprints

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

Related Articles

Fitch: Trump tax cuts could force another Fannie Mae, Freddie Mac bailout

Fannie Mae, Freddie Mac would need another bailout in severe economic crisis

Compass Point: Fannie Mae, Freddie Mac will need another bailout

Ben Lane is the Senior Financial Reporter for HousingWire. In this role, he helps set a leading pace for news coverage spanning the issues driving the U.S. housing economy. Previously, he worked for TownSquareBuzz, a hyper-local news service. He is a graduate of University of North Texas. Follow Ben on Twitter at @BenLaneHW.

Recent Articles by Ben Lane

Mr. Cooper unveils digital mortgage plan

Ocwen moves closer to profitability amid extensive business changes

Ocwen reaches mortgage servicing settlement with Hawaii

Flat fee, tech-focused real estate firm Reali raises $4m to fund expansion

Services Guide

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

HousingWire Comment Policy

Comments are intended for housing and mortgage industry professionals to respectfully discuss their trade.
Please read our Comment Policy before commenting.

3 Comments HousingWire samuallau

Recommend Share Sort by Best

Join the discussion…

Dr. Phlerman • 5 hours ago
It's not clear that Fannie Mae and Freddie Mac needed a bailout in the first place. The government is hiding documents under claims of national security as we speak.
2 • Reply • Share ›

Gary Crabtree • 4 hours ago
No bailouts period. The GSE's need to go away permanently. They spew waste and inefficiency and are a hindrance to free enterprise system. With their dominance, they control the real estate markets with their loan limits, and computerized underwriting and valuation reviews.
1 • Reply • Share ›

Tim Cornelison • 5 hours ago
Your headline is a bit short sighted and misleading. The tax reform proposed will lead to stronger gse's in the long run and will help us move towards a more natural market.

We will still need the same number of housing units but the government will not be pushing renters into a making a purchase. The market will be driven to create the housing that people want.

This will also take the federal government out of the role of subsidizing the bloated governments of the states which are gouging those who do want to own their homes. You will see some of the "high cost" high tax markets lose their draw and you will see more companies relocating to states where taxes are owner friendly.

On the surface I love this plan because it will force reform and a normalization of prices across this country. Those in the NE, the Western states with high tax rates will have some tough years but the individual wins.
1 • Reply • Share ›

ALSO ON HOUSINGWIRE

Ocwen will use Black Knight for mortgage servicing operations
2 comments • a day ago
Dee — MSP platform is the best in the industry. BAC should consider using it too rather than have multiple systems that do not communicate.

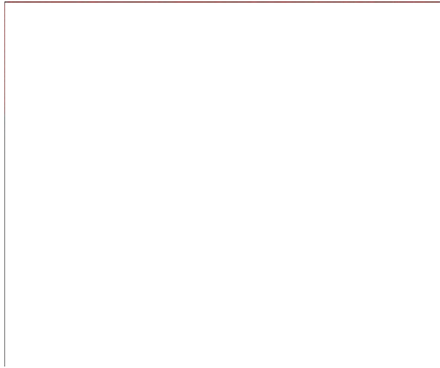
Urban Institute: Some cities might be close to a housing bubble
3 comments • 3 days ago
VP — Only cities with high paying jobs have increased in housing value, the rest of the country is in stagnation. So if you remove NY city, California silicon valley, Hawaii, Denver and …

Bill introduced to eliminate FHA life of loan insurance premium
3 comments • 7 days ago
Dee — Perhaps Ms. Waters will donate her own money to any shortfalls in the future due to defaults and low monies in the MMIF fund. Many are so short sided in this view. I'm not …

Industry advice: Homebuyer education benefits lenders, homeowners, and the industry
1 comment • 2 days ago
Bill Johhson — Does this education of the borrower include the breakdown of how their appraisal fee is spent? Are they told that up to 50% of the fee is split off to an appraisal …

Subscribe Add Disqus to your siteAdd DisqusAdd Privacy

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)



The Latest News — Nowhere Else

Sign up and we'll keep you up to date.

Your Email Sign Up
Thank you for subscribing. Expect to receive your newsletter within two business days.
Receive HousingWire's
Daily & Breaking News

- **[Fannie Mae CEO: We are now devoting attention to mortgage servicing tech]**

Jacob Gaffney

- **[Q&A with Ron Terwilliger: How would you rate our nation's housing policy?]**

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

Jacob Gaffney

- **Industry advice: Homebuyer education benefits lenders, homeowners, and the industry**

Jonathan Lawless

Industry Events

- 01 Nov

ComplianceEase 2017 Risk & Compliance Summit

San Francisco, CA

- 13 Nov

NRMLA 2017 Annual Meeting & Expo

San Francisco, CA

- 13 Nov

Accounting and Financial Management Conference

San Antonio, TX

This month in HousingWire magazine

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

October/November 2017

[A conversation with HUD Secretary Ben Carson]

[Subscribers Only] U.S. Department of Housing and Urban Development Secretary Ben Carson recently sat down with HousingWire Editor-in-Chief Jacob Gaffney for a conversation. Carson discussed housing, his plans for HUD and why he accepted a cabinet position from the guy he lost the GOP nomination to, Donald J. Trump. All photos by Stephen Voss.
Subscribe Now

Feature

Weed Wager: How banks are finding an opening to serve marijuana businesses

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

Caroline Basile
Real Estate
[Subscribers Only] With recent changes, banks are finding an opening to serve lucrative marijuana businesses. Nationally, 29 states have now legalized marijuana in some form, either recreationally, medicinally, or both, generating billions of dollars in sales. These billions of dollars mean there is much that banks could make from this booming industry, but federal laws and guidance have made things complicated for financial institutions who want in.

Commentary

The true digital mortgage

Joe Tyrrell
LendingHomeowners
We hear a lot these days about the benefits of the "digital mortgage." The term is widely overused, yet its promoters have largely under-delivered on its true promise. Often they are simply referring to the online applications that have been available for well over a decade. If the digital mortgage really streamlines that process, why does it still take up to 60 days to close a loan?

HousingWire.com

- HousingWire Magazine

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)

- Access All Issues
- Mortgage Lending News
- Mortgage Servicing News
- Mortgage Investment News
- REwired Blog

HW Community

- HW Insiders Award
- Rising Stars
- HW TECH100
- HW Vanguard Awards
- Women of Influence

Company

- About Us
- Advertise
- Recognition Awards
- Editorial Policies
- Ad Submission Portal
- Licensing & Reprints
- Contact & Support
- Contributor Submissions

Connect With Us

© 2006-2017 HW Media, LLC. All rights reserved. | Privacy Policy | Terms of Use

Design, CMS, Hosting & Web Development :: ePublishing

Print to PDF without this message by purchasing novaPDF (http://www.novapdf.com/)