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GSE reform bill could be Congress' last chance

A draft of a much-anticipated housing-finance reform bill in the U.S. Senate Committee on Banking, Housing, and Urban Affairs was recently leaked to the media. The bill envisions a system where multiple smaller-scale versions of the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac would purchase and securitize mortgages — a plan that resembles, in many respects, the system proposed by the Mortgage Bankers Association (MBA). On Monday, MBA President David Stevens discussed the bill and its chances.

What are your impressions of the bill?

The first thing I really encourage lenders to do is read the actual bill, and do not listen to people who have an ax to grind and maybe say things about it that aren't true. I read an interesting blog this morning that was filled with misinformation.

My view is a couple of things. First, I know that many readers of Scotsman Guide would just as soon have this thing go away, and let the GSEs go ahead and do what they are doing now. Everybody needs to realize that that is the least likely possibility. One, [Federal Housing Finance Agency "FHFA" Director Mel] Watt's term ends at the end of December, and there will be a new director in there. It is very likely that the new director will have a much more conservative view of how big a role the government should play in the housing market. We saw that with Acting Director Ed DeMarco, prior to Mel Watt coming in, where he was raising guarantee fees and trying, in essence, to crowd in private capital. So, change is going to happen.

The second option for the administration is to do administrative reform. Many senior officials in the administration have talked about it. So, if we don't get something done, they may try to reform it themselves. It could theoretically result in an extreme recapitalization and release, which would likely leave no government guarantee.

We, at the MBA, look at this legislative option as our one good chance to try to get something done right. It is a draft. It is a draft that was broadly circulated among staff on the Hill. They have since added and refined it further. I am looking forward to seeing something more recent, but there are a lot of good things in there.

And some of the features you support would be?

It takes Fannie and Freddie and spins them into new guarantors, and then allows for a few others to join in. Our view is that creates more competition for lenders' business and, in many ways, will most likely drive prices to a lower common denominator. It keeps a guarantor model in place, which is good. That is what keeps the full faith and credit of the U.S. backing the government security, which will keep the 30-year fixed rate loan.

But there are a bunch of things in the draft that are really important for lenders. One is, there is a lot of language around leveling the playing field. There is no legislative text, per se, that protects lenders large and small from having equal access to the system. This legislative text actually legislates a level playing field. Same price, same credit terms for all lenders, large, small, bank or nonbank. It even goes further to say that the guarantors themselves can't be owned by any single lender, a big bank, as it were. It can't be owned by it. It can't be affiliated with it. It can't be a subsidiary of. In fact, no institution can own more than 5 percent of the stock of a guarantor. So, that keeps a bright line between the primary and secondary market. All of these things are really designed to make sure that nobody gets a dominant advantage in the new market, but everybody gets access to it.

There are two other points. Everything would flow into a single security through the common securitization platform. So, if you are a lender, whether you choose to sell loans to one guarantor or three or four of them, they all have, on the securitization side, one price.

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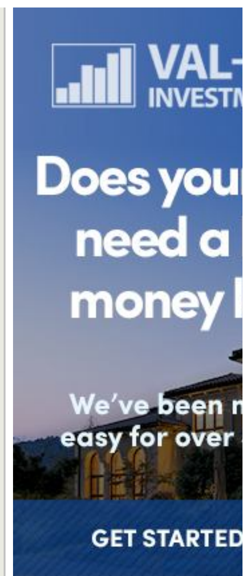
Finally, about affordable housing. Today, [for affordable housing generated by guarantee fees] there is about $4 billion based on the current production in the marketplace. In the new fund, it comes up $5 billion [per year]. If anything, that may go up a little bit. So, it is a big winner. And, what is different in the goal structure this time is the way the GSEs do it. The way the GSEs [now] do it, they create a product that basically subsidizes lower FICO scores. The challenge with that is there are some wealthy borrowers income-wise that have lower FICO scores who can benefit from an affordable-lending program that the GSEs put out. This targets the money to first-time homebuyers at or below 100 percent of median income, or other borrowers that are 80 percent or below area median income. It really is income targeted. That is going to target places like Baltimore and Detroit that have concentrations of lower-income populations that really need the access to affordable housing.



The final piece is loan limits. Basically, [loan limits] remain exactly where they are today. All and all I think it is a workable piece of legislation.

Are there areas were the draft could be improved?

One is that our model was a utility model. It had a maximum rate of return. The reason for this was you don't want a bunch of people setting market pricing that will drive returns well above where a reasonable financial institution should have returns. That will, for one, drive up pricing to consumers. These guys already have a market advantage because they are going to be approved by charter to get access to the system. You don't want to have them use that as a point of leverage to line the pockets of a bunch of shareholders in an inappropriate way. We like the regulated return because the utility structure, we thought, would create what we thought would be more patient capital.

You want to avoid running off the edge of the cliff to constantly appease your shareholders. Utilities tend to be much more patient capital in the marketplace. It is better for pricing and it is better for stability. That is one area that we probably would have kept in, but I think the view of the writers is, because you have real competition, and they have to have X number of guarantors, there is a belief [that] prices stay very competitive anyway. Looking at the banking system today. They are struggling to get high, single-digit returns on equity. There is a theory that you solve the utility concern simply by having real competition. I think that is worth a debate.

The other point that we think will make it better is if the guarantors in the system had to serve all markets. We don't think a guarantor should be able to pick a regional market. A, it could look like cherry picking. Or worse, it could be viewed as trying to avoid certain higher-risked markets that others might be forced to enter. If you required a guarantor to serve all markets, like Fannie and Freddie do today, you get a broad distribution of assets that represent the full nation's origination market. It makes for better securitization. You don't have distortions in what gets pooled into securities.

Are you concerned that if there isn't a utility model, the guarantors will push the envelope on risk. In other words, they will "race to the bottom" to fund loans?

Unlike their predecessors in the previous structure pre-conservatorship, Fannie and Freddie did the race to the bottom. That is what drove them into conservatorship. They got into all sorts of businesses they shouldn't have been in. This is different this time. One, there is no portfolio. They can't hold assets other than for the cash window and to aggregate multifamily loans before they are securitized. It is a very limited portfolio, far different from how they operated pre-conservatorship. Second is that the regulator defines the credit standard. They didn't do that before with Fannie and Freddie. In this case, the credit standard is regulated by FHFA and a guarantor can participate inside that box, whatever that credit standard is, but they can't go out of it. So, it greatly eliminates the possibility for a race to the bottom.

Housing finance reform is extremely complicated. Why should the average consumer care about this proposed plan?

That is the million-dollar question and you can even ask that of members of Congress. They tell you, "Hey, when we go back home and we do our town halls, nobody says what are you going to do about Fannie and Freddie." But they will care if we don't do something and a new regulator comes in, and starts curtailing loan limits and raising g-fees. Because, interest rates will go up or loan limits will go down, and they won't have access to a mortgage. They will care when they can't get access to it. Until then, they don't complain. It is kind of like an infrastructure bill. You know you need it when you start driving along the roads and there are potholes everywhere. The bridges are at risk. Then you want to make damn sure it is working.

In a similar way, these guys [the GSEs] are the highways to bringing capital from the global markets to your home when you want to buy one. If that gets disrupted, then there will be havoc. We have seen that in Europe where, post-recession, there is very little capital coming back in the private sector, especially for affordable housing in many markets.

Here, people don't see what is coming at them. That is the hard part of this debate. It is technical. It is not an election issue. The average consumer doesn't really know about it. The day they [American consumers] can't get a 30-year fixed loan with a good interest rate and a reasonable low downpayment, then it will be a problem. God forbid in politics that we do anything that is proactive to try to prepare for what could cause the economy and the housing system a lot of problems. But, that is what this is all about.

What chance do you give this bill for succeeding?

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It is the best chance we have had to date. Assuming the bill gets introduced in the committee, I still think this is a massive uphill challenge, primarily because of your last question. It is not a hot election issue. It is not "sexy" from a political standpoint. Nobody ran for office on it. It is just something that is really important for the system.

I think you know that I am retiring at the end of the year. If we do get a more conservative posture at the regulator and things start scaling back, I will definitely be saying a lot of "I told you so" to people, that we should have done it when we could. In the meantime, the real challenge right now is getting enough supporters on the Senate banking committee to say, "You know what, we really need to do this." That is the effort that is taking place right now.

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