

Bloomberg Intelligence

Policy Outlook: Trump Wants Return to Shareholders

Additional Intelligence on this Topic: Freddie Mac Government Primer



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Trump's Fannie, Freddie Plan Will Succumb to Political Realities

(Bloomberg Intelligence) -- Trump administration plans to privatize Fannie Mae and Freddie Mac while also reforming secondary mortgage markets relies on congressional action, which is unlikely through 2020. We expect the administration will instead be lured down the path of least resistance: selling the U.S.'s stake as-is and generating a \$100 billion or more windfall for taxpayers. (10/19/18)

1. Trump's Officially Eyeing Fannie, Freddie Payday

The key takeaway from the Trump administration's chatter is that it officially intends to privatize the GSEs. Yet how and when the government will return the companies to private ownership remains a wide-open question. The administration is deferring to Congress for now, which is important as the president still needs to confirm a new FHFA Director in 2019 to replace Mel Watt.

Congress may find utility in using Fannie and Freddie as a way to pay for a border wall or other partisan legislative priority. The sale of Fannie and Freddie could generate \$100 billion, according to estimates by Moelis. (10/19/18)

AIG One-Time Gains May Entice Trump Sale of GSEs

Proceeds From Federal Government Investment in AIG Group			
	Max combined commitment	Repayments, canceled/reduced commitments, interest/fees/gains	Positive return
Federal Reserve	\$112.5 billion	\$130.2 billion	+\$17.7 billion
Fed Loans to AIG	\$35.0 billion	\$41.8 billion	+\$6.8 billion
AIA/ALICO SPV, Preferred Interests	\$25.0 billion	\$26.4 billion	+\$1.4 billion
Maiden Lane II & III	\$52.5 billion	\$62.0 billion	+\$9.5 billion
Treasury	\$69.8 billion	\$74.8 billion	+\$5.0 billion
Common Stock	\$47.5 billion	\$51.6 billion	+\$4.1 billion
Preferred Stock	\$22.3 billion	\$23.2 billion	+\$0.9 billion
Total	\$182.3 billion	\$205.0 billion	+\$22.7 billion

Source: U.S. Department of the Treasury, <https://www.treasury.gov/initiatives/financial-stability/TARP-Programs/eng/Pages/status.aspx>

2. Ditching GSE Charters Is Unlikely

Ditching the GSEs' charters is an oft-raised yet impractical part of the administration's plan to return Fannie and Freddie to private ownership. Congress won't jump to repeal the charters without getting something in return. Doing so would cede leverage to the administration, which will become much less palatable if Democrats take control of the House in the midterm elections. To succeed in returning the GSEs to private ownership, the administration will likely have to accept that it's returning to a functional duopoly. (10/19/18)

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Key Points:

- Charters grant key privileges that cannot be replaced easily
- Granting new charters is easier than creating a new regime

Key Functions of GSE Charters:

- Federal Reserve account access
- Special tax status and legal protections
- Implicit U.S. government guarantee and funding advantage

Additional Reading:

- Fannie Mae Charter | HTTP »
- Freddie Mac Charter | HTTP »

3. Congress Could Shackle Trump to the GSEs Again

President Donald Trump risks being handcuffed to the government's stake in Fannie Mae and Freddie Mac again if his relationship with Congress sours. Senator Bob Corker orchestrated a legislative maneuver in 2015 that barred the U.S. Treasury from selling its preferred shares in the GSEs. Congress could do the same in must-pass legislation this year. Senator Corker, who plans to retire at the end of 2018, could pursue a similar prohibition on recap and release as part of his legacy on housing reform in the Senate. (10/19/18)

Government Filing

"Notwithstanding any other provision of law or any provision of the Senior Preferred Stock Purchase Agreement, until at least January 1, 2018, the Secretary may not sell, transfer, relinquish, liquidate, divest, or otherwise dispose of any outstanding shares of senior preferred stock... unless Congress has passed and the President has signed into law legislation that includes a specific instruction to the Secretary regarding the sale..."

Consolidated Appropriations Act of 2016, Dec. 18, 2015

[Click to view entire filing](#)

4. White House Punts to Congress on GSE Reform

Even as Treasury doubles down on the White House's June 21 proposal for the GSEs, we continue to focus on what the administration can achieve without Congress: recapitalizing and releasing Fannie Mae and Freddie Mac. The White House plan includes both an explicit federal government guarantee of mortgage-backed securities and the revocation of Fannie and Freddie's federal charters, neither of which the White House can achieve alone. More important are specifics on how and when to shed Treasury's stake in the GSEs once FHFA Director Mel Watt is replaced in 2019. Real progress is still a long way off.

Democrats winning the House in November mid-term elections would undercut any administration plan that requires congressional input. (10/19/18)

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Key Points:

- PSPA fourth amendment in December allowed the companies to retain up to \$3bn in loss-absorbing capital.
- White House plan most resembles the Mortgage Bankers Association's Reform Principles

Additional Reading:

- White House Fannie/Freddie Reform Proposal (see pg. 75) | MMDL »
- FHFA: Enterprise Capital Requirements | HTTP »
- MBA: "GSE Reform Principles and Guardrails" | HTTP »
- FAQ: Treasury Senior Preferred Stock Purchase Agreement | HTTP »
- Fact Sheet: Treasury Senior Preferred Stock Purchase Agreement | HTTP »

5. Future Draws to Be Increasingly Unpalatable

The status of the giant mortgage insurers at the heart of the U.S. economy isn't sustainable in the long-term. The risk of Fannie and Freddie requiring future draws from the Treasury to cover losses will remain a powerful negotiating chip as Trump delivers his housing reform agenda to a bitterly gridlocked Congress. Treasury is committed to about \$254 billion in additional funding to cover net worth deficits at the GSEs. Yet draws permanently exhaust Treasury's funding commitment, which can't be replenished. (10/19/18)

Past Treasury Payments to Fannie, Freddie

Quarter	Freddie Mac			Fannie Mae		
	Reported GAAP Net Worth	Requested Draw	Draw Date	Reported GAAP Net Worth	Requested Draw	Draw Date
2008Q3	-13.7	13.8	11/24/2008	13.8	9.4	0 N/A
2008Q4	-30.6	30.8	3/31/2009	44.6	-15.2	15.2 3/31/2009
2009Q1	-6	6.1	6/30/2009	50.7	-18.9	19 6/30/2009
2009Q2	8.2	0	N/A	50.7	-10.8	10.7 6/30/2009
2009Q3	10.4	0	N/A	50.7	-15	15 10/31/2009
2009Q4	4.4	0	3/31/2010	50.7	-18.3	18.3 3/31/2010
2010Q1	-10.5	10.6	6/30/2010	61.3	-8.4	8.4 6/30/2010
2010Q2	-1.7	1.8	9/30/2010	63.1	-1.4	1.5 9/30/2010
2010Q3	-0.1	0.1	12/31/2010	63.2	-2.4	2.5 12/31/2010
2010Q4	-0.4	0.5	3/31/2011	63.7	-2.5	2.6 3/31/2011
2011Q1	1.2	0	6/30/2011	63.7	-8.4	8.5 6/30/2011
2011Q2	-1.478	1.479	9/30/2011	66.179	-5.087	5.087 9/30/2011
2011Q3	-8.991	8.992	12/31/2011	71.171	-7.991	7.991 12/31/2011
2011Q4	-0.146	0.146	3/31/2012	71.317	-4.571	4.571 3/31/2012
2012Q1	-0.019	0.019	6/30/2012	71.336	0.268	0 N/A
No Draws From 2012 Q2 - 2017 Q4						
2017 Q4	-0.312	0.312	3/30/2018	71.648	-3.687	3.687 3/30/2018
2018 Q1	2.15	0	N/A	71.648	3.9	0 N/A
2018 Q2	4.585	0	N/A	71.648	7.459	0 N/A
Total Cumulative Draws by Both Enterprises: \$191.484						

Source: Click "Data" button to access table at FHFA website at https://www.fhfa.gov/DataTools/Downloads/Documents/Market_Data/Table_1.pdf
 Note: Excludes \$1 billion in liquidation preference on the senior preferred stock position obtained by Treasury from each Enterprise upon initiation of the Senior Preferred Stock Purchase agreements. The basis is shown in red above on the Treasury's commitment under the agreements.
 Note: Freddie Mac's draws have been based on reported GAAP stockholders' equity, while Fannie Mae's draws have been based on GAAP net worth. Both GAAP stockholders' equity and GAAP net worth are measures of the difference between an Enterprise's assets and liabilities. Both measures include realized and unrealized losses as of the reporting date. Losses ultimately realized in the future may differ from unrealized losses as of the reporting date.

6. Look to Capital Requirements to Gauge White House Timeline

The Trump administration's plan for new capital requirements for Fannie and Freddie will be a good indicator of how fast the process is moving. Treasury Secretary Steven Mnuchin elevated FHFA's work on proposed capital requirements to the Financial Stability Oversight Council on June 15, suggesting Mnuchin takes the GSE reform ideas seriously. Public comments on the proposal are due Nov. 16. FHFA could finalize the rule quickly in 2019.

Trump's current plan would require significant legislation. It's more likely the administration waits until FHFA Director Mel Watt is replaced to pursue unilateral action. It's looking increasingly unlikely that Congress will pass significant housing reform legislation through 2020. (10/19/18)

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Proposed Capital Requirements

Table 2: Fannie Mae and Freddie Mac Combined Estimated Risk-Based Capital Requirements for the Enterprises as of September 30, 2017 – by Asset Category

	Capital Requirement		
	\$billions	bps*	Share, %
Single-family Whole Loans, Guarantees and Related Securities	\$130.5	273	72%
Multifamily Whole Loans, Guarantees and Related Securities	\$13.9	278	8%
PLS	\$3.4	2,336	2%
CMBS	\$0.02	279	0%
Other (DTA)	\$26.8	811	15%
Other Assets	\$6.3	192	2%
Total Capital Requirement	\$180.9		100%

Source: "Fact Sheet: Proposed Rule on Enterprise Capital," Federal Housing Finance Agency, June 12, 2018.

7. Insider for FHFA? Maybe Mulvaney or Kudlow

OMB Director Mick Mulvaney or National Economic Council Director Larry Kudlow could be sympathetic to Fannie and Freddie shareholders if nominated to run the Federal Housing Finance Agency in 2019. Mulvaney sponsored a bill in 2016 that would have legislated a Fannie-Freddie solution similar to Moelis' plan to recapitalize and return the government-sponsored enterprises to private shareholders. Mulvaney is no fan of adding new financial regulations and would be inclined to transition the GSEs away from a taxpayer-funded backstop, though he might also be difficult for the Senate to confirm. (10/03/18)

Mulvaney Bill Mimicked Moelis Plan

114TH CONGRESS
2d Session

H. R. 4913

To ensure the sufficient capitalization of Fannie Mae and Freddie Mac and prevent any further bailout of such enterprises by the Federal Government, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES
AUG. 12, 2016

Mr. Mulvaney introduced the following bill, which was referred to the Committee on Financial Services

A BILL

To ensure the sufficient capitalization of Fannie Mae and Freddie Mac and prevent any further bailout of such enterprises by the Federal Government, and for other purposes.

As it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

SECTION 1. SHORT TITLE.

This Act may be cited as the "Housing Finance Restructuring Act of 2016".

SEC. 2. REPAYMENT OF LIQUIDATION PREFERENCE.

(a) REPAYMENT AND REDEMPTION.—Not later than the expiration of the 60-day period beginning on the date of the enactment of this Act, the Secretary of the Treasury shall modify the **Senior Preferred Stock Purchase** Agreement for each enterprise to provide as follows:

(1) DEEMED REPAYMENT IN FULL.—Effective on the date of the date of the enactment of this Act, the liquidation preference on the Variable Liquidation Preference **Senior Preferred Stock** of each enterprise is reduced to zero.

(2) REDEMPTION OF VARIABLE LIQUIDATION PREFERENCE: **SENIOR PREFERRED STOCK**.—Pursuant to paragraph (1), the Variable Liquidation Preference **Senior Preferred Stock** of each enterprise shall be redeemed upon the date of the modification of the **Senior Preferred Stock Purchase** Agreement required under this subsection and, upon and after such redemption—

Source: Congress.gov H.R. 4913, sponsored by Mick Mulvaney in 2016, would have retired the senior preferreds

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