**Calabria Senate Hearings**

**Key Point**

The Senate Banking Committee has tentatively scheduled Mark Calabria to testify on February 14 related to his taking charge of the Federal Housing Finance Agency (FHFA). This hearing is a must listen to, for anyone interested in the outlook for housing, and Fannie Mae and Freddie Mac (GSEs). Under the 2008 statute, the Housing and Economic Recovery Act (HERA), the Director of the FHFA has the right to determine when and how the GSEs would leave their current conservatorship.

It is expected that Mr. Calabria will act in concert with the wishes of the President, the Secretary of the Treasury, and Congress but he is not under any statutory obligation to do so. Therefore, it is important to understand his views. His published writings up to this point suggest the following. He will:

* Private shareholders
  + Seek some payment for the preferred shareholders.
  + Probably seek little for the common shareholders.
* Status of GSEs
  + Require the GSEs to recapitalize as traditional banks.
  + Attempt to reduce all government subsidies for the residential mortgage markets.

These actions would allow stakeholders in the GSEs to obtain some returns. They could, however, create havoc in housing finance. If the government pulled back on its implicit guarantee of 30-year fixed rate mortgages, these financial instruments would disappear driving housing prices lower and possibly causing a recession.

I have been assured that Mr. Calabria has changed his views on the 30-year fixed rate mortgage because this instrument is critical to housing. Therefore, listening to what his current thinking is will be crucial. He may be at the focal point of an economic recovery program so that he may have to support continued government intervention in housing.

**Economy Stimulus**

It appears that the growth rate of the United States economy may slow in 2019. There are two reasons for this:

* No new fiscal stimulus (tax cuts); and
* Reduced growth rates in Europe and China.

It is understood that in past recessions and/or downturns since the end of World War II, housing has been a key factor in economic recoveries. Moreover, the actions of the GSEs have been critical in stimulating housing activity.

Today, it appears that the myriad rulings impacting housing finance are preventing a recovery in this sector. Housing starts are mired at levels 35% to 40% below 2006 peaks. Therefore, even though the demographics argue for more housing activity, the deadlocks in housing finance are thwarting a recovery from happening.

Thus, the key question is what will the government do? My expectation is that despite Mr. Calabria’s past views, the Administration will ease housing finance deadlocks at both the primary and secondary market levels.

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**(Not Rated)**

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**Odeon Capital Group LLC**   
 Member FINRA, NFA,

SIPC, MSRB

750 Lexington Avenue

New York, NY 10022

Trading: 212-257-6980

[www.odeoncap.com](http://www.odeoncap.com)

Dick Bove

Senior Research Analyst

212-230-5870

dbove@odeoncap.com

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**Demographics**

More Money Not More People Drove Housing from 1990 to 2005

The United States Census Department indicates that in 1990 there were 43.2 million Americans between the ages of 25 and 34. By 2005, the peak year in the past housing boom, people aged 25 to 34 had declined to 40.1 million. The point here is that through the housing boom, the number of traditional first-time buyers had declined. They were not driving the increase in activity.

Housing was being driven by the dispersion of the population. One and two-person households virtually exploded. They grew from 53.2 million in 1990 to 67.6 million in 2005. The capability to own a home had been enhanced by the rapid growth in money supply and the surge in the amount of funds available for home finance.

In 1990, the home mortgage market was $2.6 trillion in size. In 2005 it was $9.4 trillion in size on the way to a peak of $11.3 trillion in 2008. Housing starts went from 1.2 million in 1990 to 2.1 million in 2005.

The conclusion I draw from these figures is that money drove housing in the past boom not increased demographic demands. When the ability to pay fell among the new householders, the money available for the industry dried up and housing crashed. Vacancies went from 12.1 million in 1990 to 15.9 million in 2005 even as housing growth was booming. By 2009, they were up to 19.0 million.

Demand Shifts

What is different today is that real demographic demand is increasing for housing units. The absolute number of people aged 25 to 34, which had fallen to 40.1 million in 2005, is expected to recover to 46.5 million by 2020. The people in this age cohort are expected to grow until 2025 (46.7 million) at which time their growth will stop if the Census Bureau is correct.

This cohort of the population is key to housing growth since the age of first marriage for women in the United States is 28 while it is 29 for men. More marriages mean more children. There has been virtually no growth in the number of children under 15 in this country since 2000. There were 60.3 million in that year and only 61.0 million in 2005. The number of children is expected to rise again in each of the next 6 years by a moderate but steady pace. More children mean a need for more living space – i.e., single family homes.

**Housing Finance**

A number of steps were taken by the government following the housing crisis to improve the underwriting of all types of housing finance:

* Primary level
  + More controls over land and construction finance
  + Change in mortgage underwriting rules
    - Need 20% down payment
    - All debt service payments cannot exceed 43% of pretax income.
  + Higher capital requirements against private sector loan securitizations.
  + Elimination of off-balance sheet special purpose vehicles
  + Higher capital requirements for banks overall
* Secondary level
  + GSE
    - Forced reduction in the mortgages owned in portfolio at the GSEs
    - Control over dollar amount of mortgages that can be insured by the GSEs
    - Shift in emphasis from single family home activity to multifamily home activity
    - Elimination of capital base
    - Change in liquidity rules at banks lowering the status of agency debt
  + Private market
    - Elimination of multiple derivative products
    - Higher capital requirements for banks to own privately insured mortgage backed securities
    - Lack of desire for 30-year fixed rate mortgages

These rules clearly improved loan underwriting in the residential mortgage sector. They also stifled the flow of funds into the mortgage sector.

* Commercial banks owned $2.7 trillion in home mortgages in 2005 at the height of the housing start boom ($3.1 trillion at their peak in 2008). They own an estimated $2.6 trillion today.
* The asset backed securities market was $1.7 trillion in 2005 ($2.4 trillion at its peak in 2007). They own $0.5 trillion today.
* Only credit unions have stepped up in this area. They owned $0.2 trillion in 2005 and they own $0.5 trillion today.

The position of the GSEs changed dramatically. Fannie Mae owned $363 billion in mortgages in 2005. It owns an estimated $125 million today. In 2010, it was forced to place $2.7 trillion in insured mortgages on its balance sheet. That is now $3.2 trillion. Freddie Mac figures are less clear so I would prefer not to speculate on their holdings on a comparative basis. Moreover, I do not have the Ginnie Mae figures over time.

I think, however, that the point is clear. The size of the overall residential mortgage market is smaller than it was at the time of the housing boom.

**Conclusion**

Money drives housing markets as much or perhaps more so than demographics. The lack of money flows into the sector in the past decade has been a major reason for the weakness in housing starts. Demographics would argue for more houses. Jim Herbert, the CEO of First Republic, has argued repeatedly that there is a shortage of available housing units to meet the demographic demand.

The issue as I see it is that there is a shortage of money to fund the growth in housing. This shortage is the direct effect of creating stringent mortgage rules at the primary and secondary market levels. These rules must change. Mr. Calabria will be at the forefront of explaining how the rules might change. Thus, the hearings on the 14th should be interesting.

Bottom line the country needs the legacy GSEs to return if it wants to stimulate housing and therefore the economy.

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