Insight

FHFA Reverses Previous Housing Market Reform Progress

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Executive Summary

- The Federal Housing Finance Agency (FHFA) has suspended restrictions from earlier this year that prevented the government-sponsored enterprises (GSEs) from purchasing "high-risk" mortgages; it also announced a proposal to reduce the amount of regulatory capital the GSEs would be required to hold.
- While clearly in line with the Biden Administration's goals of expanding home ownership, mortgage availability does not represent the greatest threat to home ownership—house prices and housing inventory do.
- Expanding the GSE footprint and increasing the risk held in their portfolios would undo the rare progress made by the previous administration in the direction of housing market reform, at the worst possible time, in an overheated housing market, amid the effects of the pandemic, and while the GSEs remain in conservatorship.

Context

Following a stunning *volte-face* of the Federal Housing Finance Agency (FHFA), the agency announced that the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac will once again be able to purchase "high-risk" mortgages. Just a day later the FHFA issued a proposed rulemaking on the GSE enterprise regulatory capital framework, reducing the amount of capital the GSEs would be required to hold. These actions represents a continuation of the efforts of FHFA Acting Director Sandra Thompson to undo the GSE reforms of the previous administration under Director Mark Calabria, and demonstrates the tension between two schools of thought. First among these is whether the key mandate of the GSEs is to provide affordable housing, seemingly *at any cost*, and that it is more important that the FHFA director empower this mission than perform their statutory duties as a safety and soundness regulator. The second question is whether it is the FHFA director's responsibility to reduce the footprint and enormous risk posed to the housing market by the GSEs with a view to eventually release them from conservatorship. The current FHFA's actions continue to make its position on these questions clear.

Analysis

On September 14, the FHFA announced that it would "suspend[] certain portions" of the Preferred Stock Purchase Agreements (PSPA), the regulatory agreement by which the GSEs make quarterly dividend payments to the Department of the Treasury. The "certain portions" the FHFA note refer to restrictions placed on the GSEs by former FHFA Director Mark Calabria on January 14, 2021, including caps on the GSE multifamily portfolios and on loans secured by a second home or investment properties. The most troubling implication, however, is the suspension of the restriction on "high-risk" loans, allowing the GSEs once again to purchase loans with elevated risk characteristics.

Curiously, the FHFA did not immediately also undo perhaps the key aspect of the January 14 PSPA amendment, the expansion of the amount of retained capital the GSEs are allowed to hold. Prior to January 14, the GSEs could only keep a combined $45 billion in capital before sending any additional profit to Treasury as a quarterly dividend in what is known as the “net worth sweep.” In January, the FHFA greatly expanded this to a combined $294 billion. This has two key impacts. First, allowing the GSEs to hold onto more capital makes them significantly less vulnerable to economic stress (and indeed, the GSEs do not hold anything like the capital they would be required to by the Federal Reserve were they private entities). Second, building up this capital was considered the single-most important aspect of Director Calabria’s plan to eventually release the GSEs from conservatorship. While this particular aspect of the January 14 PSPA amendment was left alone, the FHFA only a day later proposed easing the enterprise capital requirements on the GSEs from the 4 percent set under the previous administration to 3 percent, in effect cutting the combined capital requirement of the GSEs from $294 billion to $220 billion.

One additional complicating factor is the directorship of the FHFA itself. Critics of the January 14 PSPA amendment note that these significant changes to the GSE capital holdings and business model came only six days before the end of the Trump presidency. This argument is weakened slightly due to the five-year nature of FHFA director appointment; although January 14 was six days before President Trump left office, the same was not (at the time) true of FHFA Director Calabria. On the other hand, the decision to suspend the January 14 PSPA amendment, and numerous other significant policy reversals, are being made by an acting director of the FHFA who is not Senate-confirmed. Worse, the Supreme Court’s decision that the governance structure and in particular the leadership of the FHFA is unconstitutional was reason enough to remove former-Director Calabria, but the Biden Administration has not proposed an alternative. This leaves the current acting director operating in precisely the same fashion.

Conclusions

The question as to the appropriate role of the GSEs in the housing market is one of competing policy priorities. For some, it seems the only consideration of the GSEs should be the expansion of availability and provision of affordable housing. But even if this were the case, it is not particularly evident that mortgage availability is currently the most significant barrier to home ownership. House prices, housing inventory, restrictive local zoning, construction material costs, labor shortages, and the economic stresses of the pandemic are all having a far greater impact. In what is primarily a problem of housing supply, increasing housing demand (by making it easier to obtain a mortgage) is necessarily counterproductive.

For others, the key consideration is removing the GSEs from conservatorship and reducing the risk posed to the broader economy. Allowing the GSEs to purchase high-risk loans empowers lenders to make them, putting Americans in homes they cannot afford at a time when the housing market is already under significant strain. Add to these problems the inherent concerns of expanding the GSEs’ footprint and the risk concentrated in this section of the housing market, all while the GSEs are not simply in conservatorship but moving further away from ever leaving.

While the provision of affordable housing is a mandate of the GSEs, the same is not necessarily true of the FHFA director. Recent actions by the FHFA are undoing its own painstaking work to reform the GSEs, and in fact are making them larger and riskier than ever. In doing so, the FHFA is not even advancing the goal of affordable housing by addressing the key problem of the housing market: housing supply.