

GSE capital plan would make buying a home more expensive, critics say

By [Hannah Lang](#)

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WASHINGTON — Housing experts are increasingly concerned that the Federal Housing Finance Agency's new proposal to require ample amounts of more capital for Fannie Mae and Freddie Mac could make it harder to own a home.

The plan released last month, which came after the FHFA had shelved a prior capital proposal drafted under the agency's former leadership, would go into effect whenever the two government-sponsored enterprises are released from their federal conservatorship. It would require the GSEs to hold [more than \\$234 billion combined in capital](#) — over five times the amount they are currently allowed to hold.

But some critics say that jump in capital combined with added costs imposed on the companies for transferring some of their credit risk could undermine the GSEs' goal of preserving affordable homeownership. Depending on when the plan were to go into effect, some suggested it would help prolong the economic fallout of the coronavirus pandemic.

"I'm concerned it's an ideological assault on the housing economy, and it will result in extending the recession significantly," said David Dworkin, president and CEO of the National Housing Conference. "Housing has been a historic component of post-recession recovery and this rule makes that impossible."

Many see the proposed capital framework as effectively raising guarantee fees, which the GSEs charge lenders in order to cover potential losses and administrative costs. Lenders usually pass on the cost of guarantee fees to the borrower.

"G-fees would definitely have to rise," said David Stevens, CEO of Mountain Lake Consulting and a former commissioner of the Federal Housing Administration, on an investor conference call with Capital Alpha. "I think we would come up with this very steep curve that would hurt first-time homebuyers."

Mike Calhoun, the president of the Center for Responsible Lending, estimated that the proposal would translate into an increase in guarantee fees by 15 or 20 basis points, or a 30-40% increase in mortgage costs for borrowers.

But an FHFA spokesperson took issue with the claim that the capital rule would increase guarantee fees, saying it is too soon to know if that would be the effect. The agency still needs to engage with capital market participants to better assess how the proposal would impact those fees.

"As it stands today, we do not have industry and market input yet, so anyone saying what guarantee fees will look like are making grand assumptions," said FHFA spokesperson Raffi Williams.

But many believe that a hike in g-fees is simply inevitable if the proposal is finalized.

"There are two main ingredients that will go into the GSEs. One is the amount of capital that's required and this raises that by 40%, so that is going to have a massive impact on pricing," said Calhoun. "The other, and this is the second decision that has not been made is what the rate of return will be that is required for the GSEs."

Increased guarantee fees could result in lenders looking elsewhere for secondary market support to originate mortgages, potentially shrinking the size of Fannie and Freddie. It could also drive borrowers to the Federal Housing Administration, which has historically existed to provide mortgage insurance to lower-income borrowers.

“It's going to drive mortgage interest rates up or mortgage interest risk to bank balance sheets and consumers who are least able to handle it, while increasing taxpayer risk by moving mortgage volume onto FHA's balance sheet,” said Dworkin. “The bottom line is that it's bad policy, bad politics and bad math.”

A key part of Fannie and Freddie's business model is to compete for high-quality loans that offset potential losses on other mortgages. But it's not clear from the way the proposal is written whether Fannie and Freddie would still be competitive players for higher-quality loans, said Andrew Davidson, president of the financial services consulting firm Andrew Davidson & Co.

“Right now, they do cross-subsidization — basically investor loans and other high-quality loans. They make money on those to subsidize the lower-credit-quality loans,” he said. “With this higher capital, it's not clear that they will be able to continue to compete in those markets, and so their ability to cross-subsidize could be reduced, and their size and scale could be reduced.”

Stevens theorized that FHFA Director Mark Calabria's goal with his agency's capital proposal might be to transform Fannie and Freddie into guarantors of last resort.

“Mark's ulterior motive may be for the GSEs to be constrained so much that they're only used when we end up in a credit event and private capital dries up completely,” he said. “In the absence of that, private markets take up what the GSE space was, FHA takes the first time homebuyers and they skinny out.”

Many are also questioning a provision of the proposal requiring Fannie and Freddie to hold more capital when they share certain exposures with private market investors through a credit risk transfer. The plan imposes a capital charge on the amount of credit risk that is not transferred.

“It's part of the overall assault on housing and homeownership opportunities for people who need it the most,” said Dworkin about the credit risk transfer proposal.

Requiring the GSEs to hold onto extra capital for the risk they would keep on their books as a result of these transactions would likely increase the GSEs' cost of capital, said Davidson.

“The fact that you're increasing capital and you're decreasing the value of credit risk transfer necessarily means that you're going to increase the cost of those entities,” he said. “And there's a penalty on growth as well, so that's going to further increase the cost of equity.”

Calhoun also expressed concern that the credit risk transfer proposal would undermine one of the GSEs' largest successes in conservatorship.

“The challenge is, the rule does not give credit for the transfer off of risk through credit risk transfers in computing the leverage ratio,” he said. “That has potential to dramatically change the economics and desirability of having credit risk transfers.”

Yet the FHFA said in its proposal that it drafted the post-conservatorship capital framework “in a manner that would help ensure affordable access to credit for borrowers across the risk spectrum.” The agency added that the rule would bolster the stability of the GSEs, and noted that post-financial crisis regulatory capital requirements imposed on banks did not significantly limit access to credit or increase borrowing costs.

The FHFA's new plan largely tries to address concerns that the previous proposal issued under former FHFA Director Mel Watt would be too procyclical and could leave Fannie and Freddie severely weakened in a crisis. The new plan would establish several separate capital buffers that the companies could dip into during times of stress and build up as the economy stabilizes.

“Having an appropriate capital rule as a first-order matter is about creating mortgage market stability,” said Ed DeMarco, president of the Housing Policy Council and former acting FHFA director. “What hurts affordability and hurts everybody is a system that is itself not stable through a financial cycle.”

But some feel that the proposal fails to address the burden that the countercyclical requirements would impose on low-to-moderate income borrowers.

“You're going to say in good times, you have to pay a lot more on your mortgages to cover the costs ... and that because you're in a vulnerable household, you're going to pay a lot more than other people do,” said Calhoun. “That's reinforcing a structural problem that [the coronavirus crisis] has made so apparent — the underlying wealth gap.”

Davidson said it is also difficult to analyze the full impact of the capital framework on affordability without knowing how the FHFA plans to spin Fannie and Freddie out of conservatorship, said Davidson. The likely recession that the economy is confronting is only compounding that ambiguity.

“We have a public policy goal right now of using the mortgage market to spur economic recovery, and it seems that creating uncertainty as to the functioning of that system is not really good timing from a public policy standpoint,” he said.

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