Introduction to Government Sponsored Entities

Thursday, May 23, 2019 3:45 – 5:00 pm

Fannie/Freddie 101. Introduction to the Government Sponsored Entities (“GSEs”) Fannie Mae, Freddie Mac, and Ginnie Mae. Panelists will give a background on the creation of the GSEs as well as a discussion of the products GSEs offer and how they operate. Panelists will give a discussion of latest developments with GSEs, including expansion into affordable housing and new products available. The panelists will give practice pointers to audience members.

Presentation Outline

I. Introduction to the panelists:
   - Alonso Cisneros: Private sector attorney at Troutman Sanders; represents lenders in Fannie Mae and Freddie Mac loans
   - Susan Campbell: Private Sector attorney at Blanco Tackabery; represents borrowers in the financing of multifamily properties
   - Robert Kearbey: Associate General Counsel, Freddie Mac Multifamily – Targeted Affordable Housing and structured finance division
   - Lauryn Enrico: Senior Policy Advisor, Federal Housing Finance Agency

II. General Introduction to GSEs (Keely Downs)
   a. GSE stands for “government-sponsored enterprise.” They are private companies, but were created by acts of congress, and provide public financial services in terms of facilitating borrowing. We’re going to be talking about the housing GSEs: Freddie Mac (created in 1970), Fannie Mae (created in 1938). These entities purchase mortgages from lenders on the secondary market, and then bundle and sell the loans as mortgage-backed securities (which they also guarantee), thus increasing the flow of credit that lenders can provide to borrowers. Ginnie Mae (created in 1968 when Ginnie Mae was bifurcated from Fannie Mae) guarantees payment to the holders of Ginnie Mae securities, which hold loans insured or guaranteed by certain federal entities. We will be focusing on multifamily loans as opposed to single-family residential loans as well as structural issues in this presentation.

III. Introduction to FHFA, and what is the difference between Fannie Mae, Freddie Mac?
   a. What is the Federal Housing Finance Agency?
i. In the 2008 financial crisis, the US Government bailed out Fannie and Freddie (spending over $187 billion). Fannie and Freddie are now within the conservatorship of the FHFA. Fannie and Freddie did repay the bailout money with interest

b. What is the difference between Fannie Mae and Freddie Mac:
   i. Fannie Mae buys mortgage loans from large commercial banks, whereas, Freddie Mac mostly buys them from smaller “thrift” banks.
   c. As a regulator, the FHFA levels the playing field between the two. Is there a need for two different models?
   d. Introduction to the FHFA scorecard? What is the volume cap and volume cap exclusions and how does this relate to affordable housing?

IV. What is Ginnie Mae and how is it different from Freddie and Fannie?
   a. GNMA is a wholly-owned US government corporation within HUD. Private lenders make loans and obtain federal insurance or guarantees, from FHA, VA, Rural Development, or PIH ($184 loans). The lender then pools the loan or loans, which are sold to investors. Ginnie Mae guarantees the timely payment of principal and interest to the holders of these securities in the event the lender is unable to do so.
   b. Explicit guarantee
   c. Market share increased from 5% (2007) to 22% (2008) to 33% (2017).

V. What is Freddie Mac’s role in the marketplace, and some of the products that Freddie Mac offers, including in the affordable space?
   a. Freddie Mac takes the risk away from taxpayers.
   b. History of when Freddie entered the affordable space
   c. Products offered

VI. What does a Fannie and Freddie deal look like from borrower and lender counsel perspective: (1) How long take to process? (2) How much gets negotiated? (3) Is there a government submittal? (4) What does the opinion look like? Can it be revised?
   a. What is the range of transactions you see: deal size? New acquisitions? Refinancing?
   b. Timing of transactions: From loan application to loan closing; from loan closing to the time a loan gets purchased.
   c. Practice tips for practitioners:
      i. What typically gets negotiated in these deals?
      ii. Opinions: I would not encourage modifications from the forms.
   d. Describe how the two agencies approach the underwriting differently.
e. Describe other differences between the agencies. How does borrower’s counsel approach them differently?

VII. Advice for borrower’s counsel or lender’s counsel. Insight into differences in the deal documents between the agencies

VIII. What proposals have been offered for the future of these housing GSEs. There is some reform proposed, but why? Why don’t we just stay where we are? Can you give us some idea of what the proposals are?

** Also we should note that these are by no means the outlook of Freddie Mac or the FHFA.

a. GAO Report (January 2019)
   i. GSEs and Ginnie Mae have insured or guaranteed 95 percent of all mortgage backed securities since 2008- concentrates risk with federal government.
      1. 2018 letter from Director of FHFA- conservatorship is unsustainable.
      2. Congress has increased loan limits for FHA-insured loans, provided explicit guarantee (which provides a competitive advantage), and Federal Reserve has become one of the largest purchasers of MBS issued by the GSEs and guaranteed by Ginnie Mae.
   ii. Share of nonbank issuers has increased.
      1. Concerns: liquidity and lack of regulation for safety and soundness.
      2. FHFA holds no statutory authority to regulate nonbanks even though they conduct business with the GSEs
         - Hold some contractual authority to regulate.
         - Ginnie Mae issuers required to continue to make payments to security holders. Inability to do so increases risk to Ginnie Mae.
   iii. Mortgages originated since 2009 have performed better than those originated before 2008 but remain largely untested.
      1. Recent changes in underwriting standards (ex. Increased LTV and DTI ratios) create risk.
      2. Refinancing decrease may cause lenders to relax standards to increase loan volume.
   iv. Affordability concerns
      1. Home prices increasing in many metro areas.
      2. Construction and land prices increasing.
3. Qualified mortgage exception (allows DTI above 43%) expires in 2021.

b. Proposed guiding principles from various parties include:
   i. Retain the 30-year mortgage;
   ii. Maintain liquidity and stability of market throughout business cycle;
   iii. Avoid market disruption associated with transition;
   iv. Create a regulator with independence to carry out its mission;
   v. Protect borrowers by providing consistent useful information;
   vi. Provide information for investors to adequately assess risk;
   vii. Provide an explicit government guarantee for MBS, not GSEs;
   viii. Distribute risk;
   ix. Encourage competition;
   x. Provide a level playing field for primary and secondary market participants;
   xi. Recognize costs;
   xii. Preserve existing infrastructure that worked;
      • multifamily
   xiii. Clearly separate primary and secondary markets;
   xiv. Maintain commitment to affordable housing (both single family and multifamily); and
   xv. Take a holistic approach that considers how policy will affect current structure and actors.

c. Models
   i. Reconstituted enterprises
      1. Recapitalize the GSEs and release them from conservatorship.
      2. Retain the existing federal charters.
         • Possible without legislative action
      3. Independent regulator to oversee safety and soundness.
      5. Concerns: Risk related to competition remains.
   ii. Multiple guarantor system with explicit federal guarantee
      1. Multiple private sector guarantors purchase and aggregate eligible mortgages into MBS.
      2. Explicit federal guarantee of MBS if . . .
         • Guarantors utilizes private credit enhancements to absorb credit risk on front end and back end; and
         • MBS meets certain regulatory criteria (ex. qualified mortgage standards).
      3. Expanded role for Ginnie Mae beyond government insured or guaranteed loans.
4. Regulator to charge and collect g-fees and set capital requirements
   • G-fees fund mortgage insurance fund
5. Various guarantor proposals related to GSE structure, role and number of potential market participants.
   • Mutuals v. utilities.
   • Issue securities v. provide guarantee/insurance.
6. Common securitization platform: role varies depending on the proposal.
   • Make data available to market participants to reduce barriers to entry.
7. Goal: Increase competition, create level playing field, continue the 30-year mortgage, and address extremes of the business cycle.
8. Concerns: Barriers to entry for new firms and negative consequences of competition.

iii. Government corporation
1. Replace the GSEs with a single government corporation to issue MBS.
2. Government corporation to manage exposure.
   • Transfer credit risk to private sector.
   • Maintain capital as required by regulator.
3. Use g-fees to fund mortgage insurance fund to add protection to taxpayers.
4. Goal: provide stability during economic downturns, equitable lender access, target underserved groups, and address negative aspects of competition.
5. Concerns: Government retains the risk, and ability of corporation to attract and retain staff.

iv. Completely privatize market without explicit federal guarantee
1. Revoke GSE charters and gradually wind down the GSEs.
2. Provide no federal guarantee of MBS.
3. Goal: Allow private sector to create the market.
4. Concerns: Implicit government guarantee and potential reduction in availability of credit, particularly in times of economic stress.

v. Affordability component
1. Some proposals maintain the GSE housing goals, others do not.
   • Concerns: liquidity and potential for geographic distortions.
4. Multifamily market remained profitable through the housing crisis; single family and multifamily business independent of one another.
   - Opportunities to improve and better serve vulnerable populations and provide small multifamily properties.
   - Rehabilitate and preserve existing affordable housing.

5. Future role of federal housing insurers and guarantors

   vi. White House memorandum: Federal Housing Finance Reform (March 27, 2019)

   1. HUD and Treasury directed to draft proposals for reform.