MBA Summary and Analysis:
January 2021 Amendment to the GSEs' Preferred Stock Purchase Agreements

On January 14, the U.S. Department of the Treasury and the Federal Housing Finance Agency amended the terms of the Preferred Stock Purchase Agreements (PSPAs) governing Treasury's support of the GSEs. This amendment was widely telegraphed by senior administration officials and was expected due to the GSEs nearing the maximum amount of capital reserves ($45 billion combined) that the PSPAs permitted. Absent increases to this threshold, the GSEs likely would have returned to sending all profits to Treasury in the near future, rather than retaining them to build their capital positions.

In addition to years of dedicated advocacy on housing finance reform, MBA in recent months has engaged in extensive work to ensure that any amendment to the PSPAs would not disrupt the mortgage market or cause harm to borrowers, lenders, investors, or other market participants. In particular, MBA has cautioned against a premature release of the GSEs from conservatorship before they are adequately capitalized and appropriate market conduct reforms have been put in place by FHFA and/or Congress. The PSPA amendment agreed to on January 14 does not release the GSEs from conservatorship. Instead, it institutes a series of requirements and conditions that provide further clarity on the steps needed for the GSEs to exit conservatorship, as well as limits on the GSEs' businesses and roles in the market. Further details on this amendment follow.

Market Conduct

<u>Lender Access to the Secondary Market</u>

- Prohibits the GSEs from providing favorable pricing or variances to lenders based on their size, charter type, or volume of business.
    - <u>Change from Status Quo:</u> *FHFA had instituted a conservatorship directive to this effect, but a PSPA amendment represents a more durable policy reform that should remain in place beyond the GSEs' conservatorships.*
    - <u>Why it Matters:</u> *This "level playing field" reform has been a core tenet of MBA's advocacy on housing finance reform. Past GSE practices to provide favorable pricing or variances to certain lenders drove underpriced guarantee fees, spread weak underwriting standards, and concentrated counterparty risk.*

- Beginning on January 1, 2022, no lender can deliver more than $1.5 billion in loans through the cash window <u>to each</u> GSE in a rolling 4-quarter period.
    - <u>Change from Status Quo:</u> *The GSEs do not currently have a uniform per-lender cap on cash window volume.*
    - <u>Why it Matters:</u> *Many lenders currently sell more than $1.5 billion in loans through the cash window to one or both GSEs on an annual basis. Those lenders will need to limit their cash window sales starting next year and shift some loan sales to an MBS execution (or sell to aggregators, hold loans in portfolio, or find alternative outlets for these loans). MBA will raise our concerns on this issue to future Secretary Yellen and FHFA Director Calabria.*

Retained Mortgage Portfolios

- The retained mortgage portfolios of each GSE will be limited to $225 billion as of December 31, 2022.
  - Change from Status Quo: *This represents a decrease from the current caps of $250 billion for each GSE.*
  - Why it Matters: *MBA has long advocated for smaller limits on the GSEs' retained mortgage portfolios, as these portfolios were the source of many of the outsized risks taken by the GSEs in the pre-2008 period. MBA has advocated for the GSEs' retained mortgage portfolios to be used primarily for cash window operations, delinquent loan buyouts and loss mitigation, and limited multifamily purposes.*

Market Footprint

Single-Family

- Limits will be placed on the GSEs' ability to acquire loans with multiple higher-risk features. In any rolling 52-week period, a GSE cannot have more than a 6 percent share of its purchase-loan volume and a 3 percent share of its refinance-loan volume consist of loans with two or more of the following features: 1) combined LTV ratio above 90 percent at origination; 2) DTI ratio above 45 percent; or 3) credit score below 680.
  - Change from Status Quo: *While the GSEs maintain credit standards for loans to be acquired, this requirement represents a new limit on the share of a GSE's loan acquisitions that contain certain features.*
  - Why it Matters: *In Q3 2020, Fannie Mae's loan acquisitions included a 13 percent share with LTV ratios above 90 percent at origination, a 12 percent share with DTI ratios above 45 percent, and a 4 percent share with credit scores below 680. It is unclear what share of loans contained two or more of these features, nor is it clear whether the new limits will materially alter the GSEs' businesses. The announcement from Treasury stated that these caps will keep these "higher-risk…acquisitions at current levels." Questions regarding how this requirement will be put into place also must be addressed.*

- Limits will be placed on the GSEs' ability to acquire loans secured by investment properties or second homes. In any rolling 52-week period, a GSE cannot have more than a 7 percent share of its acquired loans consist of investment properties or second homes.
  - Change from Status Quo: *The GSEs do not currently maintain public limits on the share of their loan acquisitions represented by investment properties and second homes.*
  - Why it Matters: *In Q3 2020, Fannie Mae's loan acquisitions included an 8 percent share of loans secured by investment properties or second homes. In Q3 2020, Freddie Mac's loan acquisitions included a 6 percent share of loans secured by investment properties or second homes. The new limits should not materially alter the GSEs' businesses.*

- Beginning no later than July 1, 2021, the GSEs will implement programs to ensure that all loans they acquire are QM loans, loans exempt from the CFPB's Ability-to-Repay requirements, loans secured by investment properties (subject to the limit on share of acquisitions above), refinances with streamlined underwriting for high LTV ratios, loans originated with temporary underwriting flexibilities due to exigent circumstances, or loans secured by manufactured housing.
    - Change from Status Quo: *This requirement largely appears to mirror existing limits on GSE loan acquisitions while in conservatorship.*
    - Why it Matters: *There should be little change in the types of loans that are eligible for purchase by the GSEs (other than the volume of certain types of loans, subject to the limits on share of acquisitions above). Notably, acquisitions of cash-out refinances were not limited. More broadly, MBA has cautioned that any limits on the market footprints of the GSEs should feature "dials" rather than "switches," which appears to be the approach taken by this PSPA amendment.*

Multifamily

- Each GSE's multifamily business is limited to $80 billion in a rolling 52-week period, with annual adjustments for inflation (based on CPI). At least 50 percent of that business must be "mission-driven."
    - Change from Status Quo: *The $80 billion limit represents an increase of $10 billion over the $70 billion multifamily caps set for 2021. The 52-week rolling basis and annual CPI adjustment replace annual FHFA multifamily conservatorship caps.*
    - Why it Matters: *The "mission-driven" requirement, including a 20 percent subgoal, is new and untested. Treasury would need to approve changes necessary to respond to exigent circumstances (versus FHFA having the ability to adjust the caps based on market conditions). The 52-week rolling basis for the caps may cause changes to pipeline management, as well.*

Capital and Conservatorship Milestones

Capital-Related Conditions to Facilitate Exit from Conservatorship

- FHFA may release a GSE from conservatorship without Treasury approval if its common equity tier 1 capital (including retained earnings and a firm commitment for a common stock offering) equals 3 percent of the GSE's adjusted total assets.
    - Change from Status Quo: *Previously, a GSE was required to meet its critical capital levels and obtain prior Treasury approval to exit conservatorship.*
    - Why it Matters: *This provides greater clarity regarding the milestones that the GSEs must meet in order to exit conservatorship. Treasury maintains an important role in this process, as it controls when a GSE can issue common stock (see below for further details).*

- A GSE may issue up to $70 billion of common stock, but only after 1) all shareholder litigation is concluded; and 2) Treasury has fully exercised its warrant to purchase 79.9 percent of the GSE's common stock.
  - Change from Status Quo: *Previously, common stock could be issued only with prior Treasury approval, and any funds raised from the sale of common stock were required to be used to reduce the Treasury liquidation preference.*
  - Why it Matters: *As noted above, the GSEs likely will need to raise external capital in order to exit conservatorship in the coming years. This provides greater clarity on the conditions that must be met in order for such external capital raises to occur. This provision also ensures that Treasury maintains a role in the process of releasing the GSEs from conservatorship.*

- A GSE may retain earnings until its capital levels fully satisfy all its requirements under the new capital framework put in place by FHFA. Any net increases in retained earnings will increase the liquidation preference and reduce the size of the remaining Treasury backstop.
  - Change from Status Quo: *Previously, GSE capital reserves were capped at $25 billion for Fannie Mae and $20 billion for Freddie Mac. Both of those caps resulted in corresponding increases in the liquidation preference and reduction in the remaining Treasury backstop.*
  - Why it Matters: *The GSEs now will be able to further build their capital reserves through retained earnings to move (incrementally) closer to meeting the capital requirements put in place by FHFA. Absent external capital raises, however, it would take the GSEs many years to meet these requirements. MBA advocated for the GSEs to be permitted to retain earnings and build larger capital reserves as a means of promoting safety and soundness while making steady progress toward an exit from conservatorship.*

GSE Payments to Treasury

- Until a GSE meets all its requirements under the new capital framework put in place by FHFA, it pays no dividends to Treasury. After it meets those capital requirements, the dividend rate is the lesser of 10 percent of the Treasury liquidation preference or its net earnings for the period.
  - Change from Status Quo: *Previously, the dividend rate was a sweep of net retained capital greater than $25 billion for Fannie Mae and $20 billion for Freddie Mac.*
  - Why it Matters: *This change permits the GSEs to build larger capital reserves in an effort to meet the capital requirements put in place by FHFA.*

- Until a GSE meets all its capital requirements under the new capital framework put in place by FHFA, it pays no commitment fees to Treasury. After it meets those capital requirements, the GSE will pay a commitment fee to be agreed upon by Treasury and FHFA.
  - Change from Status Quo: *The GSEs also paid commitment fees prior to this amendment.*

- Why it Matters: *This change permits the GSEs to build larger capital reserves in an effort to meet the capital requirements put in place by FHFA.*

Future Housing Finance Reform Efforts

In addition to the amendment to the PSPAs, Treasury also published a "Blueprint" on next steps for reform. In doing so, Treasury, in consultation with FHFA, committed to providing Congress by September 30, 2021 with a proposal (under Secretary Yellen's direction, assuming she is confirmed) for restructuring Treasury's investments in the GSEs. The "Blueprint" focuses on five areas of consideration for future work:

- Building the GSEs' equity capital;
- Determining the GSEs' capital structures;
- Setting commitment fees for ongoing government support of the GSEs;
- Establishing appropriate GSE pricing oversight by FHFA; and
- Assessing the appropriate market concentration of the GSEs.

Notably, the "Blueprint" calls for further research to determine the optimal number of mortgage guarantors, acknowledging consideration of additional guarantors as well as consolidation of the GSEs into a single guarantor. Treasury also expresses its support for legislative housing finance reform that authorizes an explicit, full faith and credit federal guarantee for the GSEs' MBS, noting that Congress is best positioned to adopt comprehensive housing finance reform.

This is the sixth amendment to the terms of the PSPAs. It remains the case that any future Treasury Secretary and FHFA Director can jointly agree to further amend the PSPAs as they see fit.