Last week, the president issued the following memorandum directing the heads of various agencies – primarily the Treasury and HUD secretaries – to lay out a plan for housing finance reform that could be accomplished through a mix of legislative and administrative actions. The plan the president requested would be the first concrete proposal by the executive branch since 2011’s Reforming America’s Housing Finance Market. The new memo takes a broad view of the housing finance system: rather than focusing on Fannie Mae and Freddie Mac (typically referred to as the Government Sponsored Enterprises, or GSEs), it includes potential changes to FHA and Ginnie Mae, in addition to the Federal Home Loan Banks, in any plan.

While the memo leaves a lot of critical elements of a robust housing finance system to be determined, it does hint that the new system should be in some ways similar to what is currently in place, albeit with an explicit, paid-for guarantee on the GSEs’ mortgage-backed securities (MBS). Beyond that, however, the memo implies a system with reduced requirements for the GSEs to ensure broad mortgage access and affordable products for underserved borrowers and communities, and it introduces the possibility of a two-tiered market with minimal overlap between FHA and the GSEs, which would be a mistake. The preamble offers no recognition of the financing needs of multifamily properties that provide homes for renters. Consequently, the memo leaves the role of the GSEs and FHA in multifamily finance to be defined, without offering guidance or a clear indication of a sophisticated understanding of how multifamily finance differs from single-family finance, how the two categories performed during the 2009 housing crisis, or how multifamily finance supports affordable homes.

Beyond that, however, there are concerning hints of reduced support for access in affordability across the whole set of actors and little detail on, or even recognition of the needs of, financing for multifamily properties that provide homes for renters.

Memorandum on Federal Housing Finance Reform

Issued on: March 27, 2019
MEMORANDUM FOR THE SECRETARY OF THE TREASURY
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT
THE SECRETARY OF VETERANS AFFAIRS
THE DIRECTOR OF THE OFFICE OF MANAGEMENT AND BUDGET
THE DIRECTOR OF THE BUREAU OF CONSUMER FINANCIAL PROTECTION
THE DIRECTOR OF THE FEDERAL HOUSING FINANCE AGENCY
THE ASSISTANT TO THE PRESIDENT FOR ECONOMIC POLICY
THE ASSISTANT TO THE PRESIDENT FOR DOMESTIC POLICY
SUBJECT: Federal Housing Finance Reform

The President's Memorandum on Federal Housing Finance Reform: A Reader's Guide
Accordingly, it is time for the United States to reform its housing finance system to reduce taxpayer risks, expand the private sector’s role, modernize government housing programs, and **make sustainable home ownership for American families our benchmark of success.**

In order to resolve these ongoing challenges and by the authority vested in me as President by the Constitution and the laws of the United States of America, I hereby direct the following:

### Section 1. Framework to Reform the GSEs.

(a) The Secretary of the Treasury is hereby directed to develop a plan for administrative and legislative reforms (Treasury Housing Reform Plan) to achieve the following housing reform goals:

(i) **Ending the conservatorships of the GSEs** upon the completion of specified reforms;

(ii) **Facilitating competition** in the housing finance market;

(iii) **Establishing regulation** of the GSEs that safeguards their safety and soundness and minimizes the risks they pose to the financial stability of the United States; and

This would imply expanding programs and policies to support low- and moderate-income homeownership, since for wealthier income groups, the current system is delivering the mortgage credit they need. Gains in homeownership, therefore, are going to have to come from existing renters (and transitioning borrowers in risky mortgages—of which there are far fewer today as a result of Dodd-Frank—to long-term fully amortizing mortgages with affordable monthly payments).

It is disappointing that there is no mention of housing finance that supports the needs of the more than one-third of American households who rent. Given the shorter duration and non-fully amortizing nature of most multifamily mortgages, liquidity throughout market cycles for these properties is very important.

This implies the ongoing existence of the GSEs in some form rather than seeking to wind them down entirely and standing up new entities to replicate their current functions.

This could take many forms, but it is a mistake to suggest that competition doesn’t exist today in the housing finance market just because private-label mortgage-backed securities (MBS) haven’t made a comeback.

This is non-controversial.
(iv) Providing that the Federal Government is properly compensated for any explicit or implicit support it provides to the GSEs or the secondary housing finance market.

It’s refreshing to see the administration adopting the broadly consensus position that (a) there is a need for a federal backstop on MBS beyond just those issued by Ginnie Mae which securitize FHA, VA, USDA, and Public and Indian Housing loans and (b) that backstop should be paid for. That second point is important and marks a substantive change from the current system, where the GSEs historically have relied on an implicit rather than an explicit guarantee that investors would be made whole.

Given that background, including mention of “implicit support” is intriguing, as is mention of “the secondary housing finance market” separately from the GSEs. This could be interpreted to mean envisioning a future situation in which there is a revived private-label securities (PLS) market that piggybacks on the standardization provided by the GSEs and the broader market stability created by the federal backstop. Under such circumstances, it would be entirely appropriate to charge a modest fee on any PLS to avoid a free-rider problem. (The proceeds of the fee could be used to support affordable housing, since PLS carry no expectation of a guarantee.) Imposing a fee on PLS could be readily achieved if the common securitization platform currently being rolled out for the GSEs became the clearinghouse for PLS as well.

(b) The Treasury Housing Reform Plan shall include reform proposals to achieve the following specific objectives:

(i) Preserving access for qualified homebuyers to 30 year fixed-rate mortgages and other mortgage options that best serve the financial needs of potential homebuyers;

(ii) Maintaining equal access to the Federal housing finance system for lenders of all sizes, charter types, and geographic locations, including the maintenance of a cash window for loan sales;

As with a paid-for guarantee, there is a consensus that the 30-year, fully amortizing fixed-rate mortgage would not exist without a government role.
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<th>(iii)</th>
<th>Establishing <strong>appropriate capital and liquidity requirements for the GSEs</strong>;</th>
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<th>(iv)</th>
<th>Increasing competition and participation of the private sector in the mortgage market, including by authorizing the Federal Housing Finance Agency (FHFA) to <strong>approve guarantors of conventional mortgage loans in the secondary market</strong>;</th>
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<th>(v)</th>
<th>Mitigating the risks undertaken by the GSEs, including by altering, if necessary, <strong>their respective policies on loan limits</strong>, program and product offerings, credit underwriting parameters, and the use of private capital to transfer credit risk;</th>
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<th>(vi)</th>
<th>Recommending appropriate size and risk profiles for the GSEs’ retained mortgage and investment portfolios;</th>
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While this is non-controversial, it will be interesting to see how this recommendation is ultimately structured and implemented. The levels at which capital requirements are set will directly impact the cost of mortgages and, by extension, the level of homeownership—a critical success measure laid out by the president.

There are two critical structural points embedded in this objective:

1. The proposal envisions that the GSEs will continue to directly guarantee MBS rather than transition to acting solely as issuers with a federal entity (Ginnie Mae or a new agency) directly providing the insurance.

2. It presumes sufficient interest by private capital to stand up new guarantors with all the capital requirements that entails, rather than investing in MBS, the (presumably) reprivatized existing GSEs, or mortgage insurers. It is worth noting that since the **National Housing Act of 1934** first granted the FHA Commissioner (then Administrator) the authority to provide for the “establishment of national mortgage associations” which would be privately owned, no one has independently stepped forward to incorporate a new GSE.

This could create an opportunity to set loan limits based on county or metro-level house prices rather than national averages so that the share of properties eligible for conforming loans is roughly consistent across the country. Any risk mitigation should be balanced with public purpose outcomes to continue to provide liquidity to underserved markets and borrowers, as well as play an important counter-cyclical role.
(vii) Defining the role of the GSEs in multifamily mortgage finance;

(viii) Defining the mission of the Federal Home Loan Bank system and its role in supporting Federal housing finance;

(ix) Evaluating, in consultation with the Secretary of Housing and Urban Development and the Director of the Bureau of Consumer Financial Protection, the “QM Patch,” whereby the GSEs are exempt from certain requirements of the Qualified Mortgage (QM) determination;

(x) Defining the GSEs' role in promoting affordable housing without duplicating support provided by the Federal Housing Administration (FHA) or other Federal programs; and

There is a broad recognition that the multifamily businesses of the GSEs performed well during the crisis and plays a critical role in delivering capital to support affordable rental homes. While tweaks could be made to ensure financing to properties affordable to families with very low incomes, the consensus view is that the GSEs’ multifamily business lines should transition intact to a post-reform housing finance system. For more on the GSEs’ recent multifamily activities, see Preparing for Housing Finance Reform Hearings: A Multifamily Data Update.

Most discussions of housing finance reform have not included mention of the Federal Home Loan Banks (FHLBs), which are also government-sponsored enterprises (but not usually referred to as one of the GSEs, as evidenced above by this White House memo). The FHLBs are cooperatively owned by their bank (and other financial institution) members and provide advances to those members for mortgage originations. The FHLBs also play an important role in supporting affordable housing through their Affordable Housing Program, funded by a 10 percent set-aside from their earnings.

When coupled with the directive below for “attempting to ensure that the FHA and GNMA assume primary responsibility for providing housing finance support to low- and moderate-income families that cannot be fulfilled through traditional underwriting,” this section raises red flags for a number of reasons, including concerns about fair housing and disparate impact. Shrinking, rather than reinforcing, the role of the GSEs in promoting affordable housing also runs counter to the mandate to “facilitate competition in the housing finance market” by limiting the channels through which affordable mortgages might be securitized, a change that would raise costs for borrowers.

(continued on next page)
(xi) Setting the conditions necessary for the termination of the conservatorships of the GSEs, which shall include the following conditions being satisfied:

(A) The Federal Government is fully compensated for the explicit and implicit guarantees provided by it to the GSEs or any successor entities in the form of an ongoing payment to the United States;

(B) The GSEs’ activities are restricted to their core statutory mission and the size of investment and retained mortgage portfolios are appropriately limited; and

(continued:) As a core principle, public benefit should be a prerequisite for access to a valuable federal backstop by private corporations. In the context of housing finance, this has historically come in the form of public purpose obligations to support affordable housing, but the language in this directive raises concerns that it may reflect an effort to jettison those obligations to support affordable housing while offering the GSEs and any new entrants substantial private benefits without any broader responsibilities.

This is the first mention of GSE successors, but it still leaves the door open for bringing the GSEs through receivership. It is also not clear whether the payment in this directive is intended to be backward looking to recoup past support or a model for the future. (The “ongoing payment” obligation seems to be at odds with full compensation as a precondition for terminating the conservatorship.)

The GSEs’ charters, as enacted by Congress, include as one of their stipulated purposes “to provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.” Assuming legislation to implement reform does not undo any of the key purposes laid out under the GSEs’ statutory mission, affordable housing must remain part of the GSEs’ activities.
(C) The GSEs are subjected to heightened prudential requirements and safety and soundness standards, including increased capital requirements, designed to prevent a future taxpayer bailout and minimize risks to financial stability.

Any discussion of systemic risk should incorporate the entirety of the housing finance system and not just focus on the GSEs. There is a strong argument for preserving and expanding the GSEs' role in supporting access to affordable mortgages for hard-to-serve borrowers so there is more risk borne by private capital and wider internal cross-subsidization, rather than relegating those borrowers solely to FHA, where taxpayers are not protected by a private capital buffer.

Implicit in much of the way the memorandum approaches housing finance is the idea that there are relatively bright lines about which entities serve which borrowers and those remain consistent over time. The lack of discussion of the liquidity function that the GSEs provide (particularly in a countercyclical environment) is concerning. By focusing on taxpayer bailouts, the guidance here seems to encourage retrenchment during (even regional) downturns that could exacerbate house price declines rather than ensuring deep and liquid markets, as intended by their charters. Structuring any federal guarantee fees to be like FDIC insurance, which allows the government to recoup any costs of bank failures through post-funding, is a reasonable approach to maintaining liquidity, but since the issue of "bailouts" is as much about political rhetoric than fiscal cost, it is not clear whether a draw on an insurance fund, let alone tapping a Treasury line of credit to be paid back later, would be deemed a "bailout."

(c) For each reform included in the Treasury Housing Reform Plan, the Secretary of the Treasury must specify whether the proposed reform is a "legislative" reform that would require congressional action or an "administrative" reform that could be implemented without congressional action. For each "administrative" reform, the Treasury Housing Reform Plan shall include a timeline for implementation.

(d) In developing the Treasury Housing Reform Plan, the Secretary of the Treasury shall consult with the Secretary of Agriculture, the Secretary of Housing and Urban Development, the Secretary of Veterans Affairs, the Director of the Office of Management and Budget, the Director of the Bureau of Consumer Financial Protection, the Director of the FHFA, the Assistant to the President for Economic Policy, and the FHFA's Federal Housing Finance Oversight Board.
(e) The Treasury Housing Reform Plan shall be submitted to the President for approval, through the Assistant to the President for Economic Policy, as soon as practicable.

Sec. 2. Framework to Reform the Programs of the Department of Housing and Urban Development, the FHA, and the Government National Mortgage Association (GNMA). (a) The Secretary of Housing and Urban Development is hereby directed to develop a plan for administrative and legislative reforms (HUD Reform Plan) to achieve the following housing reform goals:

1. **Attempting to ensure that the FHA and GNMA assume primary responsibility for providing housing finance support to low- and moderate-income families that cannot be fulfilled through traditional underwriting;**

2. **Reducing taxpayer exposure through improved risk management and program and product design; and**

3. **As discussed in Section 1(b)(x) above, it is a mistake to have only FHA support LMI borrowers. Although this proposed directive gives FHA/Ginnie Mae “primary responsibility” for serving these borrowers, the language earlier in this memo stipulating eliminating duplication makes it hard to see how “primary responsibility” will emerge as anything but sole responsibility.**

   The mention of traditional underwriting is interesting, since we are starting to see a proliferation of tech-enabled underwriting solutions that could be adopted to lower the cost of underwriting and expand mortgage credit to previously hard-to-serve borrowers. While these models may hold great promise, there is also risk involved, and FHA, given its continued reliance on legacy technology platforms, may not be best suited to evaluate and monitor these solutions. The GSEs, on the other hand, may be far better positioned to incorporate non-traditional underwriting to help bring LMI borrowers into the conventional mortgage space.

   More generally, given the difficulty in making statutory changes to the housing finance system (and the infrequency with which it is done), it may be wise to not merely recreate the previous system, albeit with more taxpayer protections, but also to be mindful of the next generation of housing finance and develop a system that can adopt and adapt to technological innovations without needing new legislation. Otherwise large swaths of the mortgage landscape may end up unregulated.

   **Success here is likely to be highly contingent on the modernization sought in the next item, but there are also statutory changes that could be made to give FHA and Ginnie Mae greater authority to manage their risk and have more flexibility to adapt to changing market conditions.**
(iii) Modernizing the operations and technology of the FHA and GNMA.

FHA's legacy technology infrastructure is being upgraded, but it has been a slow (and expensive) process. Broader housing finance reform efforts should not be held up while awaiting completion of this effort.

(b) The HUD Reform Plan shall include reform proposals to achieve the following specific objectives:

(i) Addressing the financial viability of the Home Equity Conversion Mortgage program;

Also known as the reverse mortgage program, the HECM program has been a significant drain on FHA's capital reserves in recent years because of large up-front payments to borrowers that have left FHA with loan balances that exceed the homes' recoverable value. As with FHA modernization, challenges to developing and adopting HECM reforms should not preclude changes to the forward mortgage system.

(ii) Assessing the risks and benefits associated with providing assistance to first-time homebuyers, including down-payment assistance;

There is a comprehensive body of research that has studied the success factors for first-time homebuyers, including housing counseling and downpayment assistance. It should be noted that for many current renters seeking to become homeowners, the biggest barrier to buying a home is the downpayment rather than the ability to make the monthly mortgage payments.

(iii) Defining the appropriate role of the FHA in multifamily mortgage finance;

Any discussion of the roles of FHA, Fannie Mae and Freddie Mac should be mindful of the different products, underwriting processes, and capital structures for each market participant. FHA's multifamily offerings differ significantly from the GSEs insofar as they offer fully amortizing mortgages with terms as long as 40 years and can include construction costs in the permanent debt. Changes to any one actor should be evaluated based on the impacts to the size of the market overall and relative market shares in all phases of the business cycle and should be particularly mindful of the impact on financing for subsidized and market-rate affordable rental properties.
(iv) Diversifying FHA lenders through increased participation by registered depository institutions;

(v) Enhancing GNMA program participation requirements and standards to ensure its safety and soundness and to protect borrower and investor interests; and

(vi) Reducing abusive and unsound loan origination or servicing practices for loans in the GNMA program, including, if appropriate, by providing for cooperation with other loan program sponsors and regulators.

(c) For each reform included in the HUD Reform Plan, the Secretary of Housing and Urban Development shall specify whether the proposed reform is a “legislative” reform that would require congressional action or an “administrative” reform that could be implemented without congressional action. For each “administrative” reform, the HUD Reform Plan shall include a timeline for implementation.

(d) In developing the HUD Reform Plan, the Secretary of Housing and Urban Development shall consult with the Secretary of the Treasury, the Secretary of Agriculture, the Secretary of Veterans Affairs, the Director of the Office of Management and Budget, the Director of the Bureau of Consumer Financial Protection, the Assistant to the President for Economic Policy, and the Assistant to the President for Domestic Policy.

(e) The HUD Reform Plan shall be submitted to the President for approval, through the Assistant to the President for Economic Policy, as soon as practicable.

Sec. 3. General Provisions. (a) Nothing in this memorandum shall be construed to impair or otherwise affect:

(i) the authority granted by law to an executive department or agency, or the head thereof; or

(ii) the functions of the Director of the Office of Management and Budget relating to budgetary, administrative, or legislative proposals.

(b) This memorandum shall be implemented consistent with applicable law and subject to the availability of appropriations.
In Conclusion

As the housing finance reform process plays out in Congress and the administration, we will continue to focus on ensuring that the resulting system provides stable access to affordable single-family and multifamily credit for all eligible borrowers, both across geographies and throughout the business cycle; promotes broad access to sustainable homeownership for all creditworthy families; and expands support for rental housing that is affordable to low- and moderate-income households.