The Daily Dish

Taxpayer Risks and the GSEs

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It is hard to believe that the September 6 anniversary of putting into conservatorship housing government-sponsored enterprises (GSEs) – Fannie Mae and Freddie Mac – is fast approaching. In the moment, it was shocking testimony to the poor management of mortgage risk in the United States. In the aftermath, it was accepted wisdom that there would be dramatic legislative reforms of the GSEs, resulting in safer mortgage markets backed by private capital. Except it never happened and in a few short weeks the GSEs will mark their 15th year in conservatorship and explicitly backed by the taxpayers.

But are they any safer? Certainly there has been enormous progress in the quality of mortgage origination and the use of private mortgage insurance and other mechanisms to shift credit risk away from the GSEs and diversify it more widely. Efforts have been made to make the GSEs' capital requirements more rigorous and tied to the riskiness of their activities. And the investment portfolios (aka monoline housing hedge funds) are a thing of the past. These are all steps in the right direction.

But backsliding is easy and the temptation is constant. Despite the years under conservatorship of the Federal Housing Finance Agency (FHFA) "each Enterprise remains undercapitalized." Nevertheless, the Biden Administration's FHFA moved to relax the capital requirements.

Expanding the credit box – issuing mortgages to riskier borrowers – is an attractive way to make more money, especially if it can be done in the name of helping some deserving segment of the population. So it was unsurprising that the FHFA announced a while back that it would require Fannie and Freddie to put in place Equitable Housing Finance Plans that would aim advance equality in housing markets. For example, they would deploy a "special purpose credit program" that would assist African American borrowers with down payments. Typically, the 20 percent down payment is the responsibility of the homebuyer, or some of the capital risk is taken by private mortgage insurance. This approach shifts capital

that is supposed to protect taxpayers toward subsidizing home purchases by borrowers who simply don't have the financial preparation to do so.

For these reasons and many more, there is a special shelf in my anxiety closet for the GSEs. So I was unamused by the results of the annual GSE stress tests announced by the FHFA. This is the ninth year of GSE stress tests. Compared to last year, both GSEs fared worse in the most adverse scenario – losing roughly $8 billion instead of being able to eke out a small gain. For both, the largest source of losses was credit risk: $21.3 billion for Fannie Mae and $13.7 billion for Freddie Mac. This is exactly the kind of deterioration that one would expect if the credit box has been stretched and the economy suffers a sharp downturn (over 8 percent) and a large increase in unemployment.

The stress test results are troubling. But they are not a call to arms because evidently nothing is a call to arms in this era of legislative dysfunction. The financial and economic risks of an unsustainable budget go unaddressed. Yawn. The financial unsustainability of major planks of the social safety net go unaddressed. Yawn. The non-transparent exposure of taxpayers to mortgage credit risk are a financial iceberg. Yawn.

What will it take to get Congress to do its job?