Dan Clifton
Principal Broker and Mortgage Guru, Clifton Mortgage Services, LLC
NMLS # 284174
670 N Orlando Ave Suite 101 Maitland, FL 32751

Office: 888-681-0777 x1001
Mobile: 407-252-3039
Fax: 866-512-0169
dan@cliftonmortgageservices.com
View My Website

Will New FHFA Head Follow his Instincts or Bow to Reality?

"The most important question in housing policy heading into the new year has nothing to do with interest rates, housing supply, or home sales," Urban Institute (UI) non-resident fellow Jim Parrott says. "It's **what kind of director** of the Federal Housing Finance Agency (FHFA) **Mark Calabria will be.**"

Calabria has been named to replace Melvin Watt as director of the agency that regulates the Federal home Loan Banks and the GSEs Fannie Mae and Freddie Mac. FHFA has also been conservator of the GSEs since 2008. Parrott says the agency has "an enormous hand in **who in this country can get a mortgage and on what terms**." He adds, "And in Mark Calabria, the Trump administration has nominated one of Fannie and Freddie's greatest skeptics, raising the prospect that they, and the market that depends on them, could undergo dramatic change." He pulls out his crystal ball to speculate for UI on what those changes might be.

The conventional wisdom behind the existence of entities like the GSEs is that bundling mortgages into securities that bear no credit risk and attract hundreds of billions of dollars in annual investment expands access to long-term, fixed-rate loans. But Calabria, Parrott says, dismisses this reasoning out of hand; contending that neither securitization nor the 30-year fixed-rate mortgage is worth the trouble. Securitization facilitates an originate-to-sell model that creates too much risk and the 30-year FRM creates unhealthy distortions of the market. Why, Calabria has written, keep them at all?

This question takes on new import as he becomes a policymaker, but Parrott suggests **his approach might change as he confronts a practical reality**; these institutions are too embedded in our system to be easily removed. That he will come into office in a softening economy and as a presidential election likely to focus on that economy is revving up means "we should expect him to move more incrementally than dramatically, focusing on ways to reduce the centrality of Fannie and Freddie in the system rather than eliminate them altogether."

It isn't that Calabria would reverse course, Parrott says his views are to deeply and genuinely held to expect that, but he will be likely to proceed more cautiously than his writings would suggest. He will probably follow a course of shrinking the GSEs' footprint and reducing taxpayer risk within it.

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.37%	-0.04	0.00
15 Yr. Fixed	6.82%	-0.02	0.00
30 Yr. FHA	6.82%	-0.06	0.00
30 Yr. Jumbo	7.55%	-0.05	0.00
5/1 ARM	7.42%	-0.08	0.00
Freddie Mac			
30 Yr. Fixed	7.22%	-0.22	0.00
15 Yr. Fixed	6.47%	-0.29	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.24%	+0.11	0.66
15 Yr. Fixed	6.75%	+0.11	0.64
30 Yr. FHA	7.01%	+0.11	0.94
30 Yr. Jumbo	7.45%	+0.05	0.56
5/1 ARM	6.64%	+0.12	0.87

Rates as of: 5/2

Recent Housing Data

		Value	Change
Mortgage Apps	Apr 24	196.7	-2.67%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%

		Value	Change
Builder Confidence	Mar	51	+6.25%

There are four methods through which he could reduce the footprint; rolling back loan limits, raising prices, tinkering with loan products and/or the credit box. But a combination would be needed to reduce the footprint without pushing lending and taxpayer risk to FHA or out of the market completely. Parrott says to expect he will focus on incremental measures that allow measuring the market's response.

For example, Calabria could increase pricing for loans with balances above a certain limit, giving the jumbo market a chance to lend in a larger loan balance space without totally eliminating larger GSE loans. If demand is higher or lower than expected the pricing threshold could be moved up or down accordingly.

The prospective director could also focus on markets he is comfortable disrupting like investor properties or cash-out refinancing, shrinking the GSE footprint without upending the owner-occupied purchase market. If this works, FHFA could gain confidence it could move into comparable purchase markets **without too much disruption.**

One way to reduce taxpayer risk *within* the government's footprint would be to ensure the GSEs are off-loading most of their credit risk not just in good times but through the entire economic cycle. Today's business model is to offload risk through a combination of private mortgage insurance and pool-level credit risk transfers. Parrott says the latter is dominated by nimble investors who can move quickly and en masse to other investments as the economics shift. Calabria is likely to try to deepen involvement by investors that will remain in the market further into the cycle. This could mean requiring Fannie and Freddie to secure deeper loan-level insurance or expanding the use of pool-level structures that attract institution-based capital.

Also expect him to position the GSEs, or what might ultimately replace them, with much higher capital standards. The current FHFA regime has already proposed this but Calabria is likely to consider something like a buffer for systemically important financial institutions or a so-called countercyclical buffer.

The GSEs' capital levels are limited by their Treasury contracts, but the above standards would be a benchmark for whatever follows the conservatorship and would play a critical role in the ultimate balance struck between taxpayer protection and the cost of credit. Even in conservatorship, as capital standards flow through to pricing decisions, **any increases will lead to higher prices**, especially for higher risk loans. This will also help to shrink the GSE footprint.

In short, Parrott says, the new director is likely to proceed, albeit more cautiously than he might like, down the path he has spent his career mapping out. This will result in a mortgage market in which Fannie and Freddie play a smaller and smaller role.

As to how the markets will react, Parrott says he expects banks will step in with some portfolio lending. But will investors and private labor securities issuers resolve their issues to pick up the rest??

Another issue is the $3.8 billion cross-subsidy, a significant portion of which generated by the GSEs through pooling those loans most likely to be lost to the private market: lower-credit-risk borrowers with large loan balances, investor properties, and the like. How might the loss of these loans affect pricing for higher-credit-risk borrowers?

Calabria has expressed a consistent interest through the years in supporting affordable housing but has also expressed skepticism about current policies to increase assess and affordability. He argues they do more to drive up the price of a home than to improve access to homeownership. So which policies does he change and how?

The final question is **what is the GSE endgame?** Does Calabria put Freddie and Fannie on a path for re-privatization, put them into receivership, or wait for Congress to act?

Parrott, is owner of Falling Creek Advisors which advises bank and nonbank lenders on housing finance issues and helps smaller lenders sell loans into the secondary market. He was a senior advisor on housing at the National Economic Council during the Obama Administration and counsel to the Secretary of Housing and Urban Development.