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Housing Finance Reform Paper A Catalyst for Debate, but Action Remains Unlikely

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On February 25, the Bipartisan Policy Center (BPC) released a 136 page report detailing recommendations to reform the nation's housing policy. The report is the culmination of a 16 month undertaking by some of the most renowned figures in mortgage policy (commission members). The GSE reform proposal advanced by the BPC is very similar to earlier proposals both in tone and substance. The overarching theme is that the federal government must take a step back from its current role and the private sector, in tandem, must take on more risk. Specifically, the plan calls for the GSEs to be wound down and replaced by a government entity – a "Public Guarantor" – which would provide a "limited, catastrophic government guarantee to ensure timely payment of principal and interest" on qualified MBS. There are two elements core to this plan: (1) the guarantee will only be triggered after private capital has been fully exhausted; and (2) the guarantee is explicit and paid for through collected premiums. We believe this report will serve as a catalyst that advances the mortgage finance reform debate but have no illusions regarding the likelihood of GSE reform passing in the 113th Congress.

What Stuck Out to Us?

- The BPC commission supports the mortgage interest deduction (MID), among other tax subsidies for housing, but does note that modifications can be made. We believe this is noteworthy as it is indicative of the fact that the MID's once "untouchable" status has been weakened. In the nation's current budget environment, the ~$70 billion a year in lost federal revenue due to the MID is undeniably on the radar in the Capitol. We continue to expect marginal changes to the MID if broad tax reform is undertaken (e.g. limiting the deduction to only primary residences; limiting the treatment of home equity loans).

- The report states that there are a number of impediments to the housing market recovery including "overly strict mortgage lending standards" and "the uncertainty related to pending mortgage regulations and the implementation of new rules." It goes on to state that policymakers should "develop a plan to align" the various mortgage regulations. We expect members of Congress to seize on this finding and, as a result, for pressure to legislatively align QRM with QM to increase.

- The report estimates that a borrower without mortgage insurance would pay a G-fee between 59 and 81 basis points (bps) under the proposed system. The estimate breaks down as follows: (1) 45 – 67 bps for the credit charges for the private sector entities; (2) 8 bps for the catastrophic risk guarantee; and (3) 6 bps for the operation of the Public Guarantor. Currently, the GSEs are charging G-fees of ~50 bps. As we have stated previously, we expect the FHFA to increase G-fees by ~20 bps in 2013.

- The report contains an interesting comparison of the federal assistance – both through the tax code and direct spending – for renters and owners. As Figure 4-2 illustrates, homeowners received $120 billion in federal support in 2012 as compared to renters who received $61 billion of support.

- It appears that the commission went to great lengths to look at housing issues in the broader context. To that end, the report includes a detailed discussion of the nation's rental priorities. Specifically in our coverage, the report calls for winding down the multifamily operations of the GSEs. The report recommends implementing a catastrophic guarantee for the multifamily sector similar in structure to the single family proposal.

- The report highlighted a number of potential policy changes that could be enacted in the near-term. For example, the report called for: a measured reduction in loan limits; defining a more targeted role for the FHA; increased clarity regarding legacy mortgage putback issues; and the designation of a point person in the administration charged with streamlining regulatory efforts in the mortgage market.

Will Congress Act?

We believe this report will serve as a catalyst that advances the mortgage finance reform debate but have no illusions regarding the likelihood of GSE reform passing in the 113th Congress. We are pessimistic regarding the likelihood for GSE reform in this Congress for three reasons: (1) The Congressional calendar has quickly filled with other issues (e.g. gun control, immigration reform); (2) The current Congressional playbook is to act only when action is absolutely necessary and since the GSEs are on relatively more stable footing than 5 years ago there is no urgency to undertake reform; and (3) Before we blink an eye it will be 2014 – a campaign year – and hopes for serious governing will be diminished.

What Now?

We believe there are now three issues to watch: (1) The Treasury Department's next step in this debate; (2) GSE reform efforts in the House Financial Services Committee; and (3) Continued action from the FHFA.

On the first point, the Treasury Department has been effectively silent on the issue of GSE reform since the release of its white paper on the subject in February 2011. We believe that the Treasury Department would like to publicly refocus on the issue through the release of another position paper but that the broader political landscape has not provided them with an opportunity to do so. The BPC report will refocus attention on GSE reform which, in turn, should provide the Treasury Department with an opening to reenter the debate.

On the second point, GSE reform will be one of the House Financial Services Committee’s primary focuses in 2013. We expect Chair Jeb Hensarling (R-TX), as well as subcommittee chairs Rep. Garrett (R-NJ) and Rep. Campbell (R-CA), to push a bill out of committee in 2H 2013. We doubt that if a House bill were to be advanced this year it would be seriously considered in the Senate, but note that such an effort would represent the most attention the GSEs have received in Congress since being put into conservatorship almost 5 years ago.

On the third point, we expect the FHFA to continue taking steps to implement structural changes to the mortgage market. Specifically, we believe the FHFA will increase G-fees by ~20 bps this year and undertake new risk-sharing initiatives (please see here for our thoughts on this effort). With only minimal Congressional action expected, the FHFA remains central to the future of mortgage finance.

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