Tracking Housing Finance Reform

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Tracking Housing Finance Reform

The Treasury's report from September 2019 pursuant the Presidential Memo from March 2019, stated that:

> ***Pending legislation, FHFA should assess whether each of the current products, services, and other single-family activities of each GSE is consistent with its statutory mission and should continue to benefit from support under Treasury's PSPA commitment (with appropriate amendments to the PSPA), and in particular, FHFA should solicit information on whether to tailor support for cash-out refinancings, investor loans, vacation home loans, higher principal balance loans, or other subsets of GSE-acquired mortgage loans.***

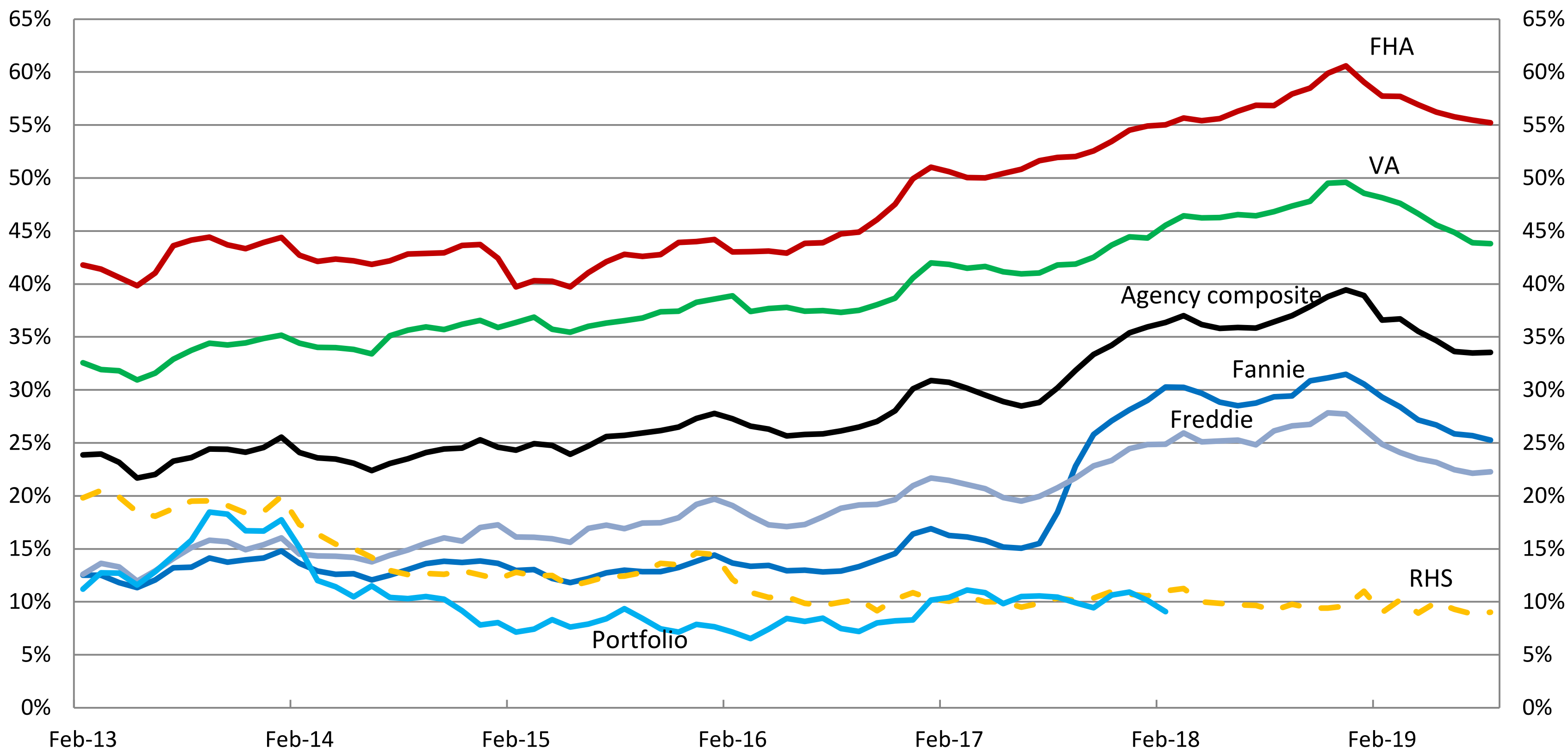
The GSEs core mission should be to assist low and moderate income homebuyers in acquiring a primary residence.

Starting today we will be tracking Housing Finance Reform from the GSEs' perspective in regards to this core mission and progress being made on the steps outlined in the Treasury report.

Source: AEI Housing Center, www.AEI.org/housing.

Purchase Loans with Total DTI Greater than 43%

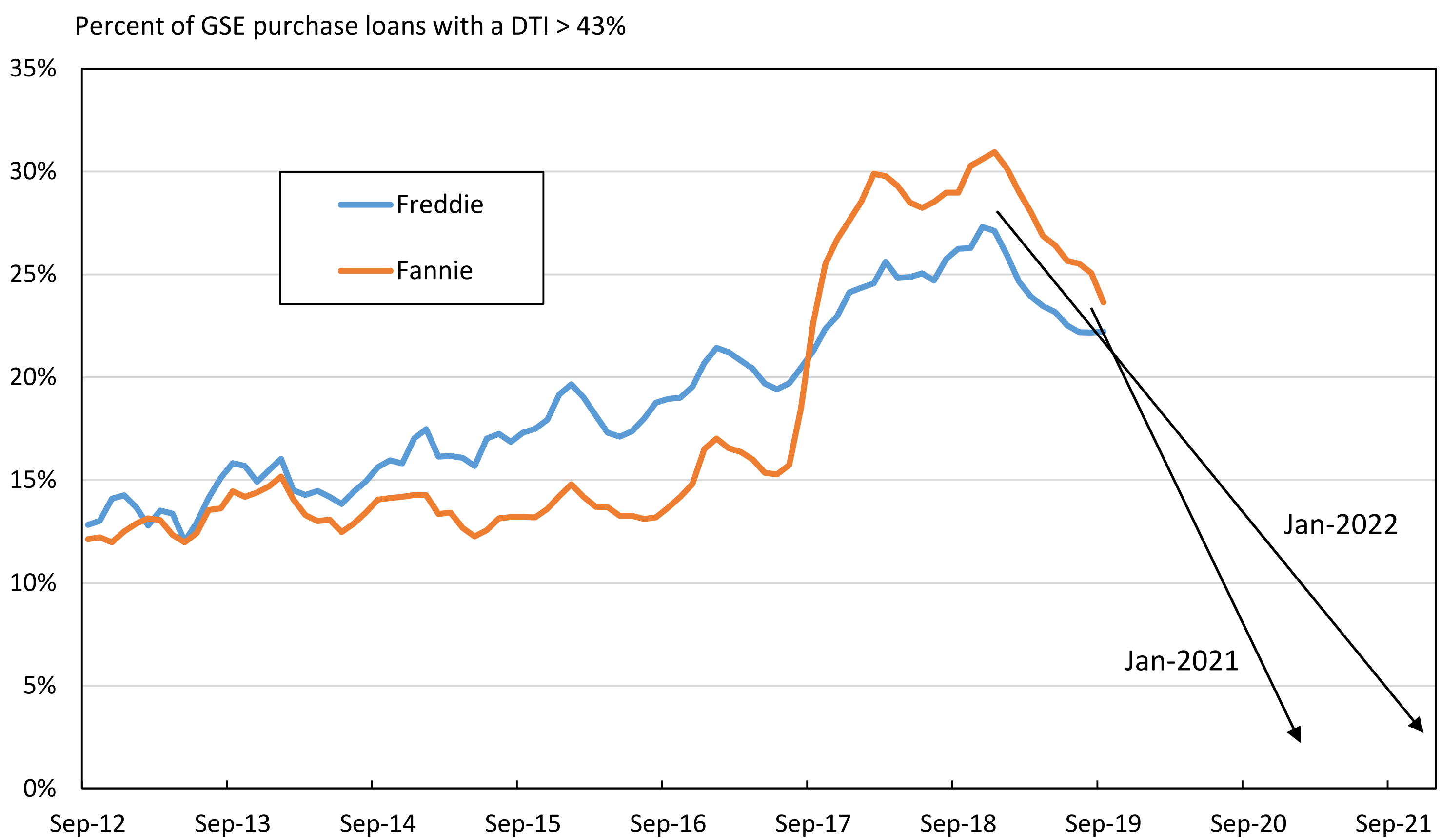
Despite the general seasonal decline in the DTI > 43 share that begins around January, this year's decline has been more pronounced. While this year's decline also coincides with a massive rate drop, some agencies (esp. FHA and Fannie) have announced their intent to reduce their share of high DTI loans or risk layering. Time will tell whether this trend is a sustainable one.



Note: Data pertain to purchase loans for primary owner-occupied properties. Data for the portfolio line come from LLMA and McDash after removing duplicative loans. The data are weighted by loan amount buckets and origination year using HMDA weights. The portfolio series is not shown for the most recent months to allow sufficient time for portfolio lenders to sell loans to the GSEs.
Source: AEI Housing Center, www.AEI.org/housing, CoreLogic, and Black Knight.

GSE Purchase Loan Share with a DTI > 43%

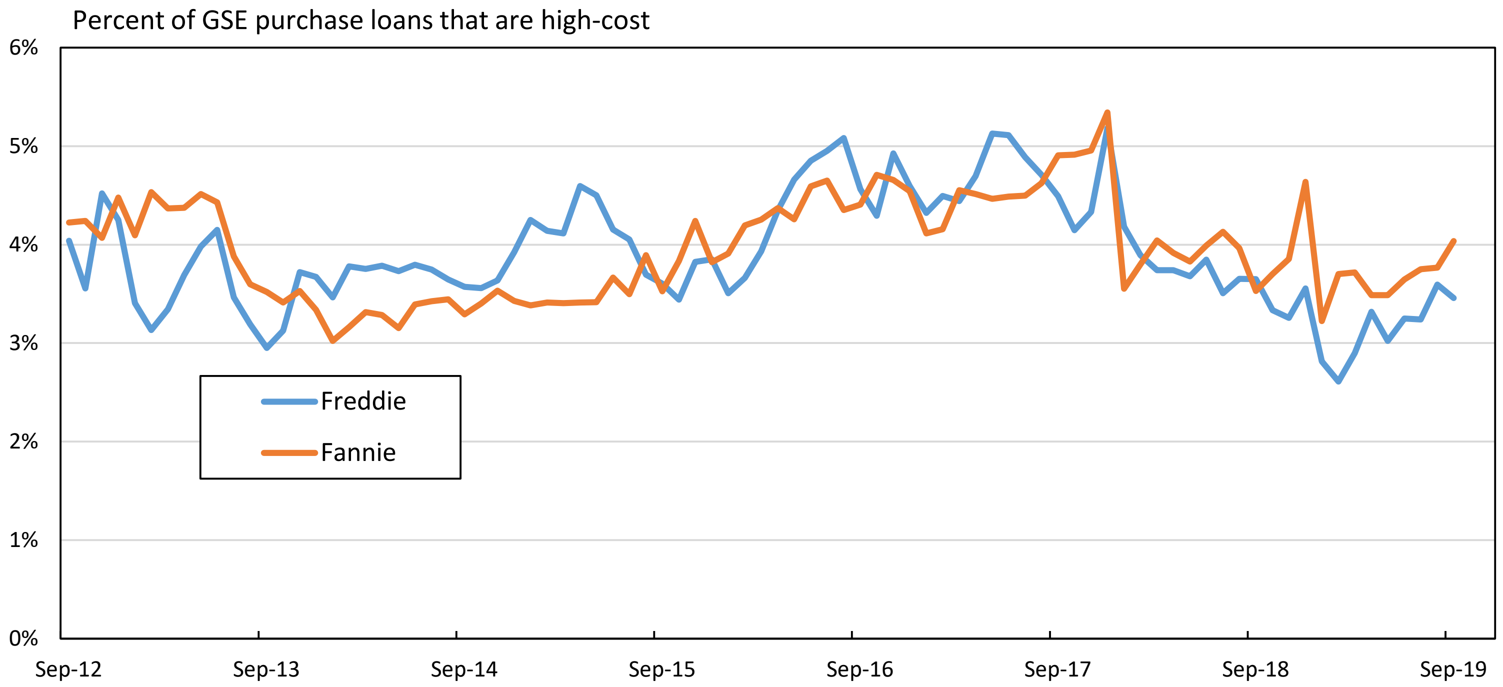
After growing to 31% and 27%, respectively, Fannie and Freddie have begun to shrink their share of loans with a DTI > 43%. With the Qualified Mortgage Patch set to expire in January 2021, the GSEs only need to slightly accelerate their current rate of shrinking this segment to meet the January 2021 sunset date.



Note: Data for September 2019 are preliminary.
Source: AEI Housing Center, www.AEI.org/housing.

High-Cost Share of GSE Purchase Loans

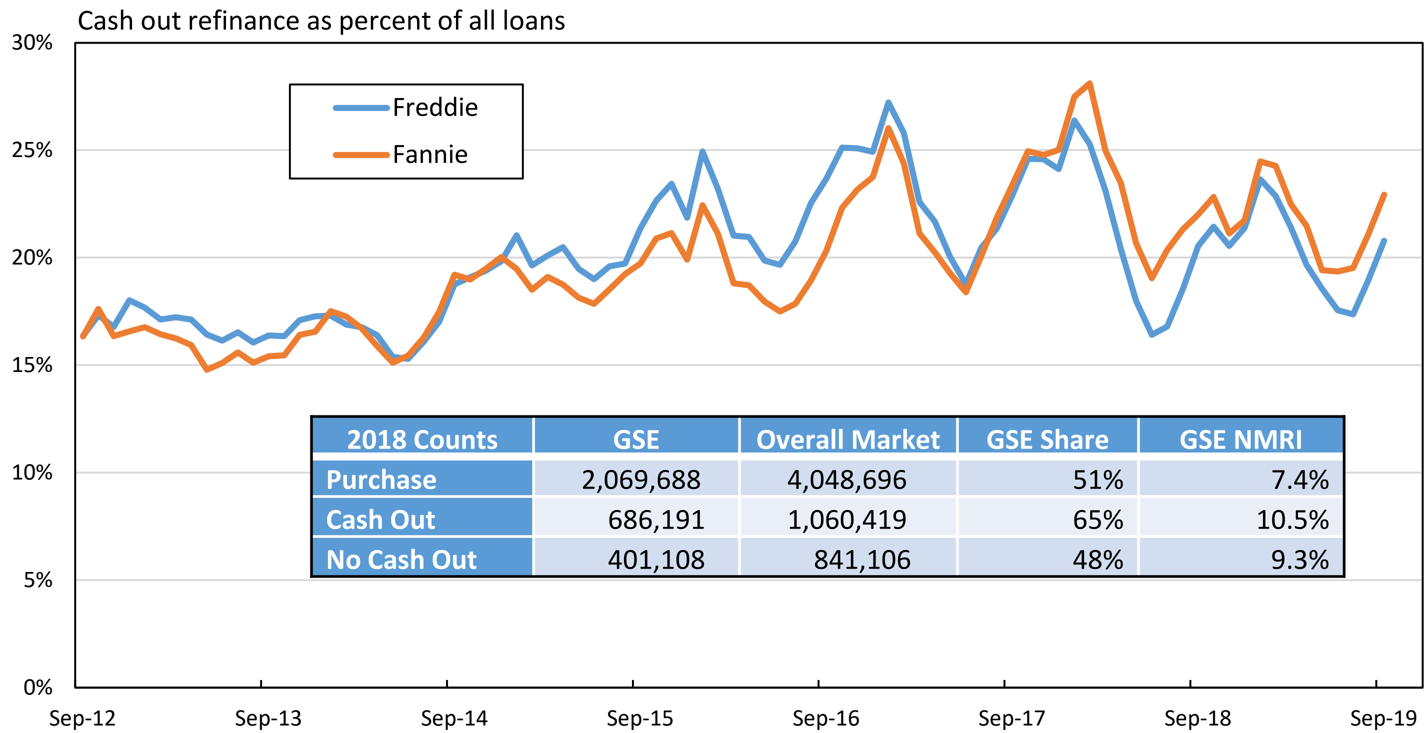
High-cost loans (those exceeding the GSE conforming loan limit set by FHFA) accounted for around 5% of the GSEs' purchase loans in 2017. Since then, that share has fallen to 3-4%. Some of this decline is due to rapidly rising conforming loan limits. Since high-cost loans crowd out competition from private lenders and were meant as a temporary fix after the financial crisis, it is best that they be eliminated entirely. At a minimum, substantial reductions could be accomplished by pricing, underwriting, or freezing high-cost limits. However, FHFA is expected to raise the conforming loan limits for 2020 to over $500,000.



Note: Data for September 2019 are preliminary.
Source: AEI Housing Center, www.AEI.org/housing.

Cash Out Refinance Share of all GSE Loans

The cash out refinance (CO) share fluctuates based on time of the year and interest rates, but since 2015, it has made up on average over 20% of all GSE loans. Especially for COs, the GSEs are holding an outsized 65% share of the overall market. COs do not help in the acquisition of a primary residence and are risky acquisitions with an NMRI of 10.5%. If the FHFA were to require the GSEs to exit this business, this would help de-risk their footprint.



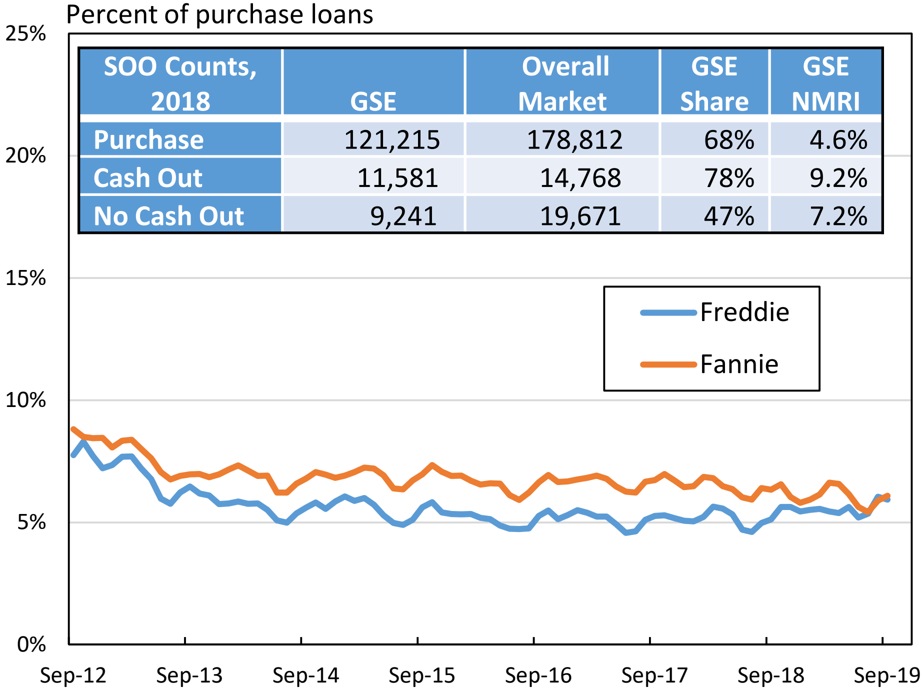
2018 Counts	GSE	Overall Market	GSE Share	GSE NMRI
Purchase	2,069,688	4,048,696	51%	7.4%
Cash Out	686,191	1,060,419	65%	10.5%
No Cash Out	401,108	841,106	48%	9.3%

Note: Data for September 2019 are preliminary. The overall market count comes from HMDA, the GSE count from the NMRI. Both datasets are censuses, which allows us to subtract one from the other.
Source: AEI Housing Center, www.AEI.org/housing, and HMDA 2018.

GSE Second Home and Investor Home Shares

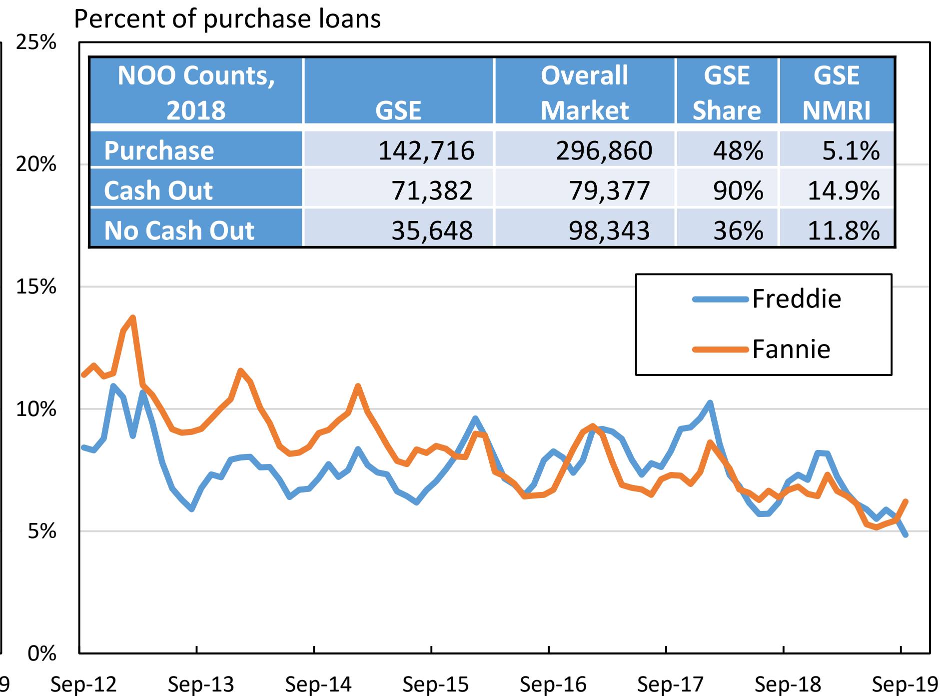
Second and investor homes combined made up over 10% of both Fannie and Freddie's purchase loans in September 2019. While the second home share has remained relatively constant, the investor share has begun to shrink. Neither of these loan types serve the GSEs' core mission and should therefore be eliminated by FHFA.

GSE Second Home Shares (SOO)



SOO Counts, 2018	GSE	Overall Market	GSE Share	GSE NMRI
Purchase	121,215	178,812	68%	4.6%
Cash Out	11,581	14,768	78%	9.2%
No Cash Out	9,241	19,671	47%	7.2%

GSE Investor Home Shares (NOO)

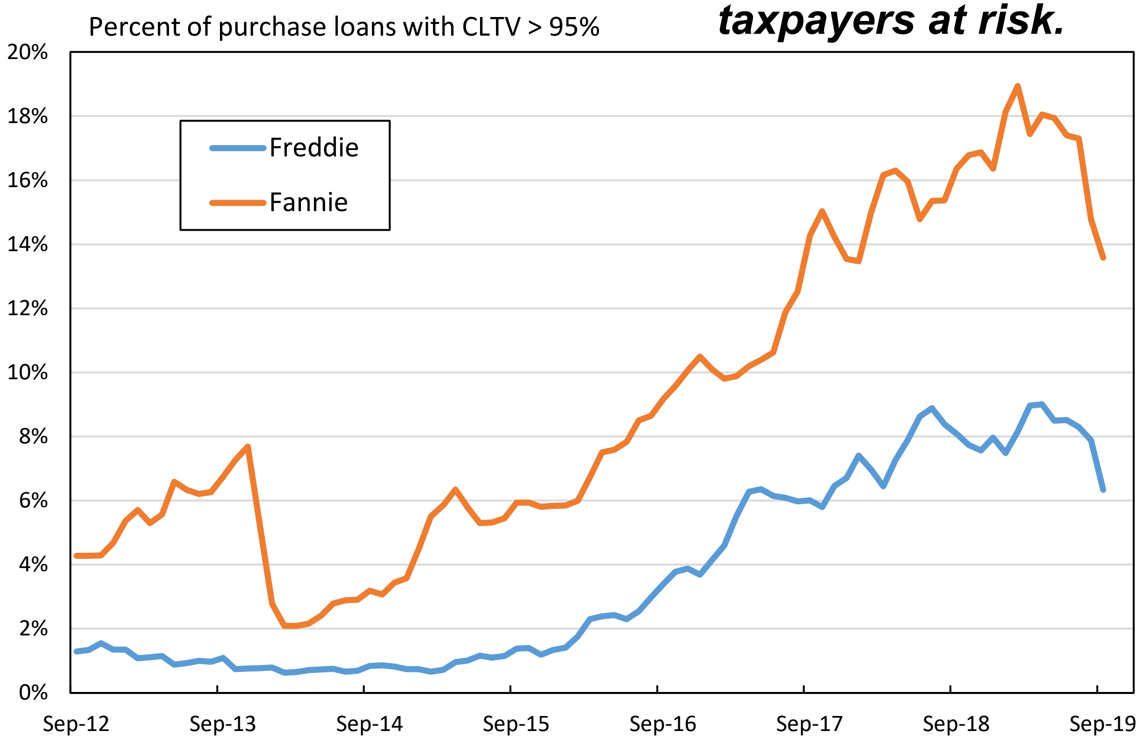


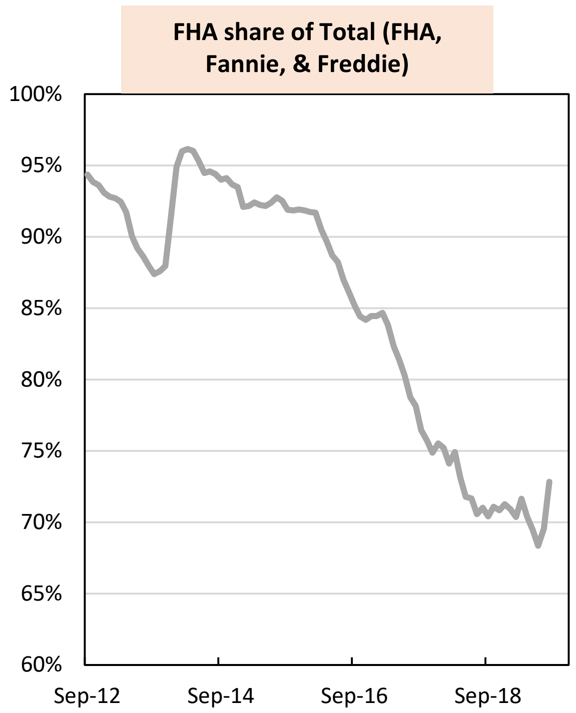
NOO Counts, 2018	GSE	Overall Market	GSE Share	GSE NMRI
Purchase	142,716	296,860	48%	5.1%
Cash Out	71,382	79,377	90%	14.9%
No Cash Out	35,648	98,343	36%	11.8%

Note: Data for September 2019 are preliminary. The overall market count comes from HMDA, the GSE count from the NMRI. Both datasets are censuses, which allows us to subtract one from the other.
Source: AEI Housing Center, www.AEI.org/housing.

GSE Purchase Loans with CLTV > 95%

The GSEs' share of loans with combined loan-to-value (CLTV) ratios greater than 95% has risen dramatically, especially for Fannie. This occurred after both agencies were forced by their regulator to aggressively reenter this market. This increased competition with FHA and moved the risk curve even further out. As of August this trend appears to have reversed. If the FHFA were to revert to the policy that limited the GSEs to a maximum CLTV of 95%, this would help de-risk their footprint and establish a bright line between the GSEs and FHA, thereby ending an inappropriate competition between agencies. This competition unnecessarily drives up home prices and puts taxpayers at risk.

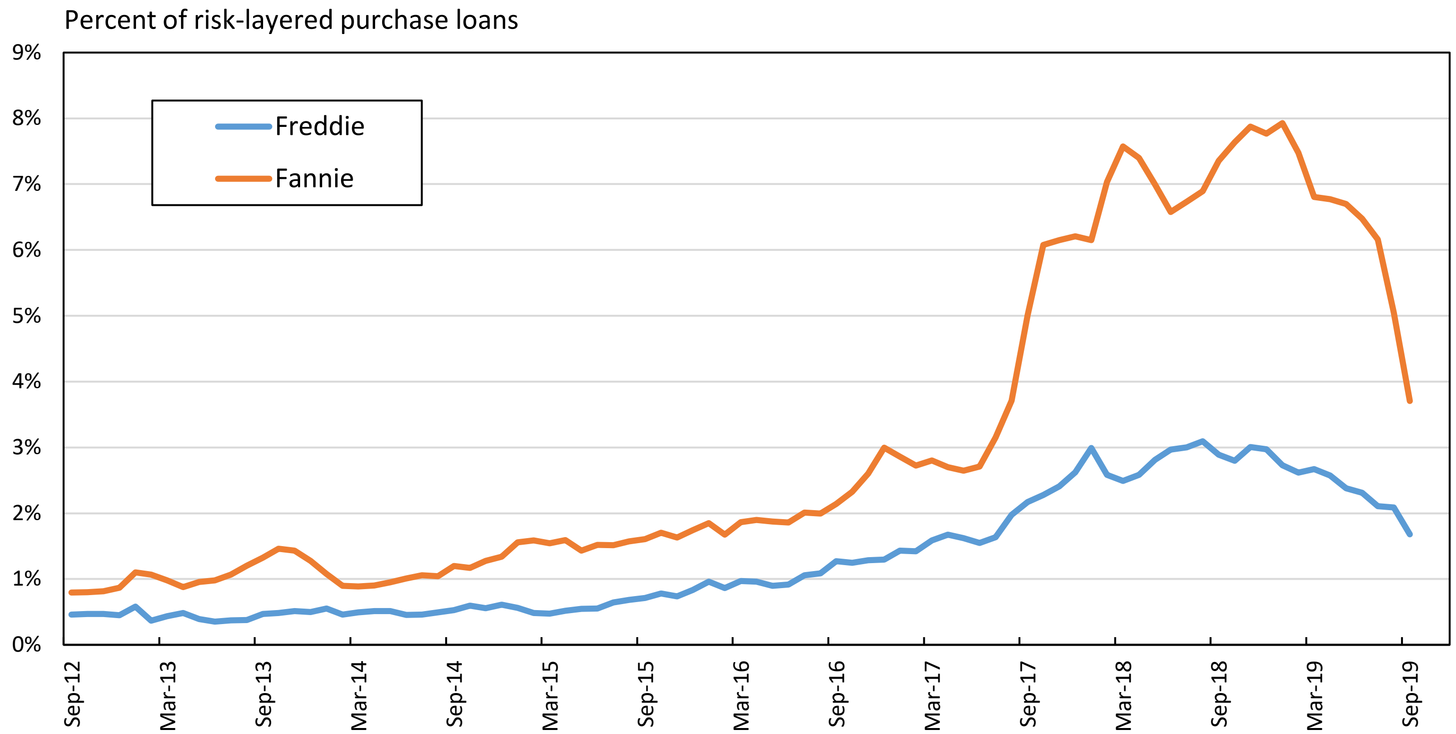




Note: Data for September 2019 are preliminary.
Source: AEI Housing Center, www.AEI.org/housing.

GSE Purchase Loan Risk Layering

Risk layering occurs when at least three risk factors are present at origination. Risk factors include: Credit score < 660, DTI > 43, CLTV > 95%, and 30 year loan term. The number of risk layered loans rose dramatically beginning in 2017 as FHFA pushed the GSEs towards higher DTIs. Fortunately, due to the reduction in high DTI shares, this trend has begun to reverse.

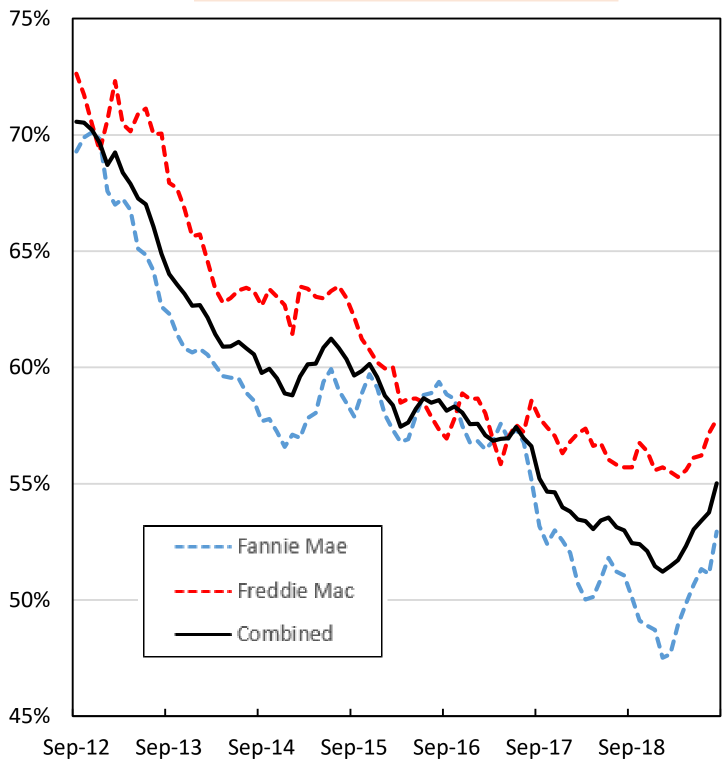


Note: Risk layering is defined as having at least 3 of 4 of the following features: Credit score < 660, DTI > 43, CLTV > 95%, 30 year loan term.
Data for September 2019 are preliminary.
Source: AEI Housing Center, www.AEI.org/housing.

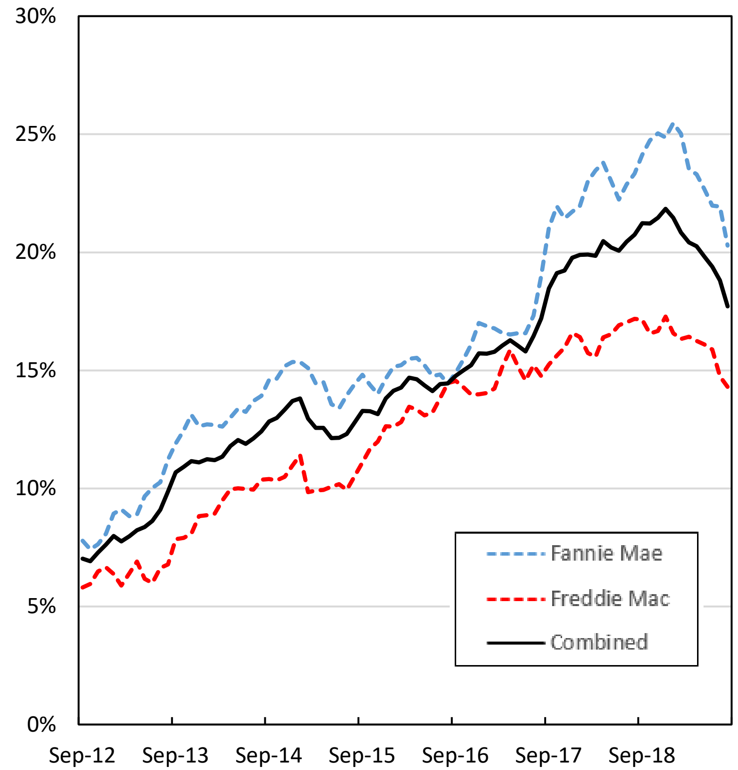
Low- & High-Risk Origination Shares, GSE Purchase Loans

There has been a significant divergence in trend between Fannie and Freddie around August 2017, when Fannie removed compensating factors for loans with a DTI above 50%. Fannie's share of low risk loans declined, while Freddie's held constant. Since January 2019, especially Fannie has managed to increase its share of low-risk loans, but still has a lot of work to do before once again being on par with Freddie.

Low-Risk Origination Shares



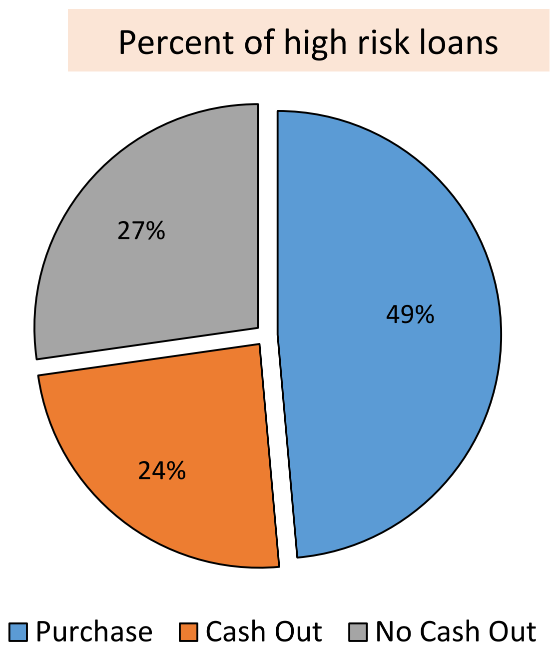
High-Risk Origination Shares

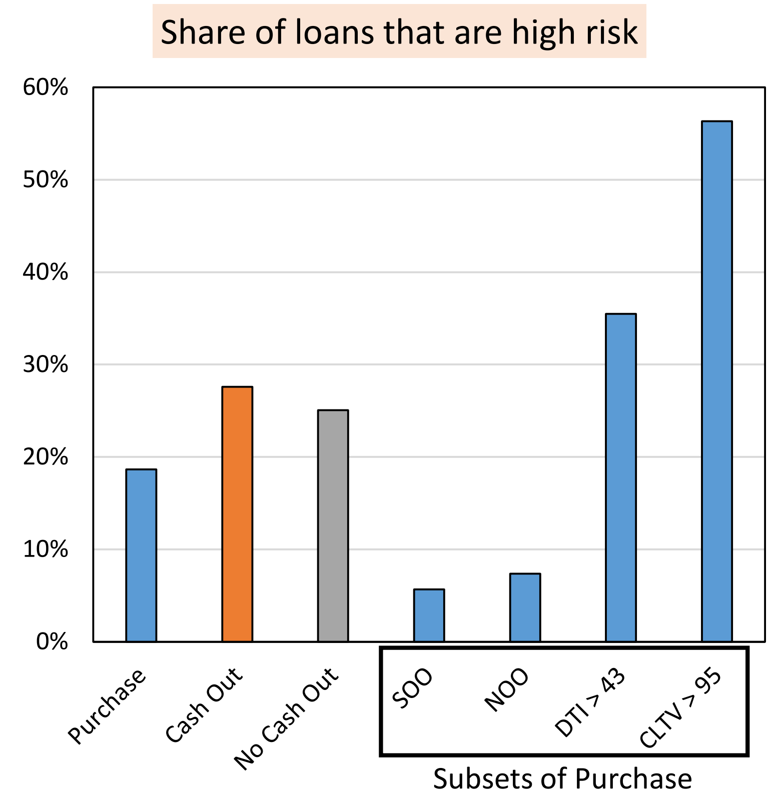


Note: We define prime loans as low-risk (with a stressed default rate of less than 6%), near prime as medium risk (with a stressed default rate of 6% to less than 12%), and subprime-like as high risk (with a stressed default rate of 12% or greater).
Source: AEI Housing Center, www.AEI.org/housing.

De-risking the GSEs, All Loans

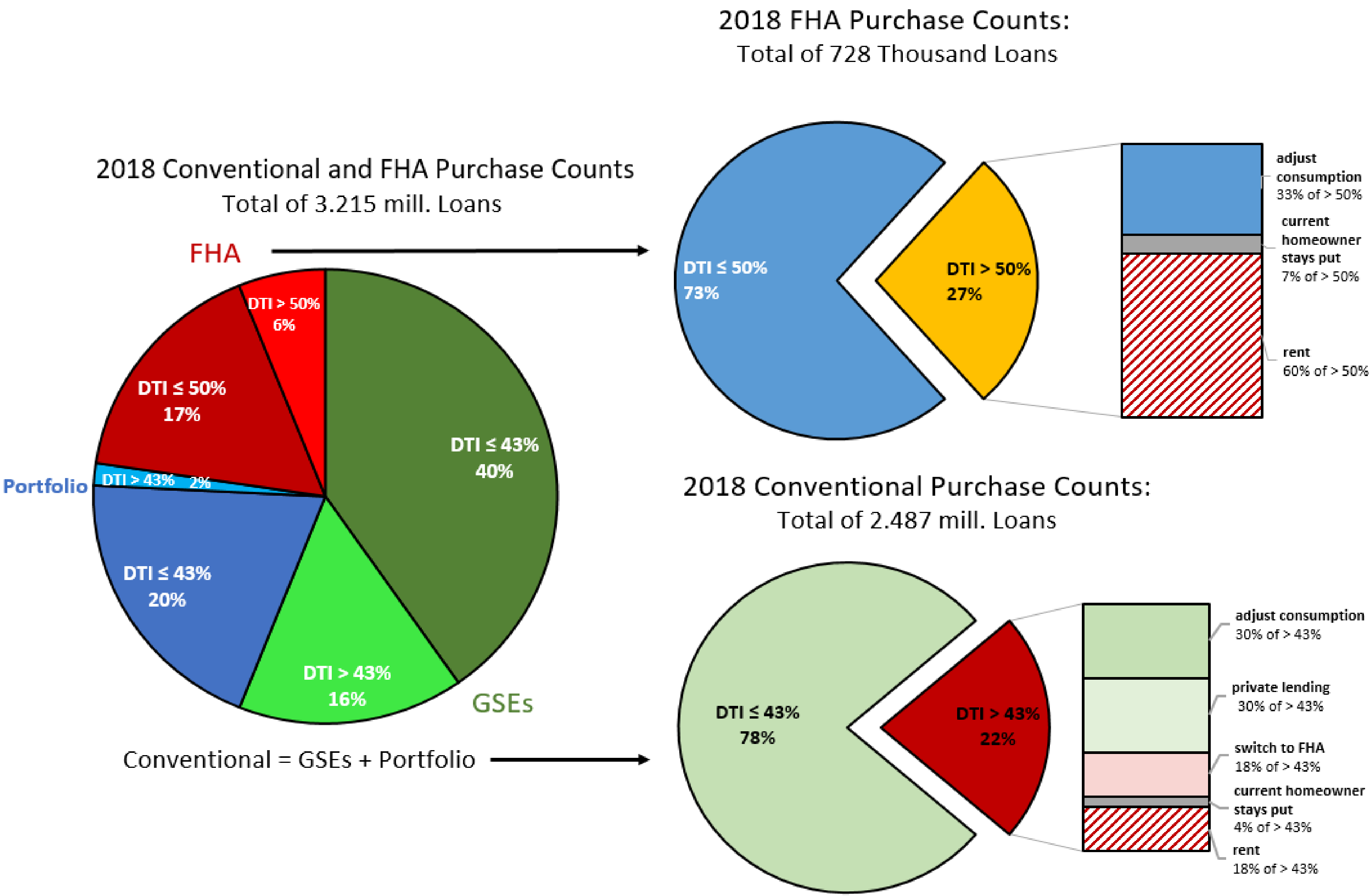
The FHFA Director has set as a goal the de-risking of the GSEs' footprint. High risk loans (those with an MRI greater than or equal to a 12% stressed default rate) currently account for 21% of their August footprint and could be eliminated. The GSEs' high risk loans are about evenly split between purchase loans and refis. The biggest risk drivers are purchase loans with CLTVs > 95%, DTIs > 43%, and refis.





Note: Data are for June-August 2019. SOO refers to second owner occupied loans and NOO refers to investor owner occupied loans. High risk loans have a stressed default rate of 12% or greater.
Source: AEI Housing Center, www.AEI.org/housing.

What would happen to loans after the Patch expires and FHA limits its DTIs to 50?



Note: Data are for primary owner-occupied loans. Portfolio loans are calculated by taking the difference in loan totals from HMDA 2018 for conventional loans and AEI's National Mortgage Risk Index for GSE loans. Conventional loans with missing DTIs are assumed to have the same distribution of DTI > 43% as the rest of the population.
Source: AEI Housing Center, www.AEI.org/housing.