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What's Ahead for Housing Finance Reform: Motion, Not Progress?

By John J. McKechnie

Let's be blunt: Congress could have tackled the complicated but nonetheless critical issue of housing finance reform in 2018. Instead, they experienced what NASA would call a "failure to launch."

The continuing inability of Washington to reshape and revitalize Fannie Mae and Freddie Mac means the conservatorship is likely to extend into 2021.

Obstacles will remain into the next Congress, and maybe the next Administration. And don't look to Treasury to attempt significant changes to GSEs either. So what kinds of changes, if any, are possible?

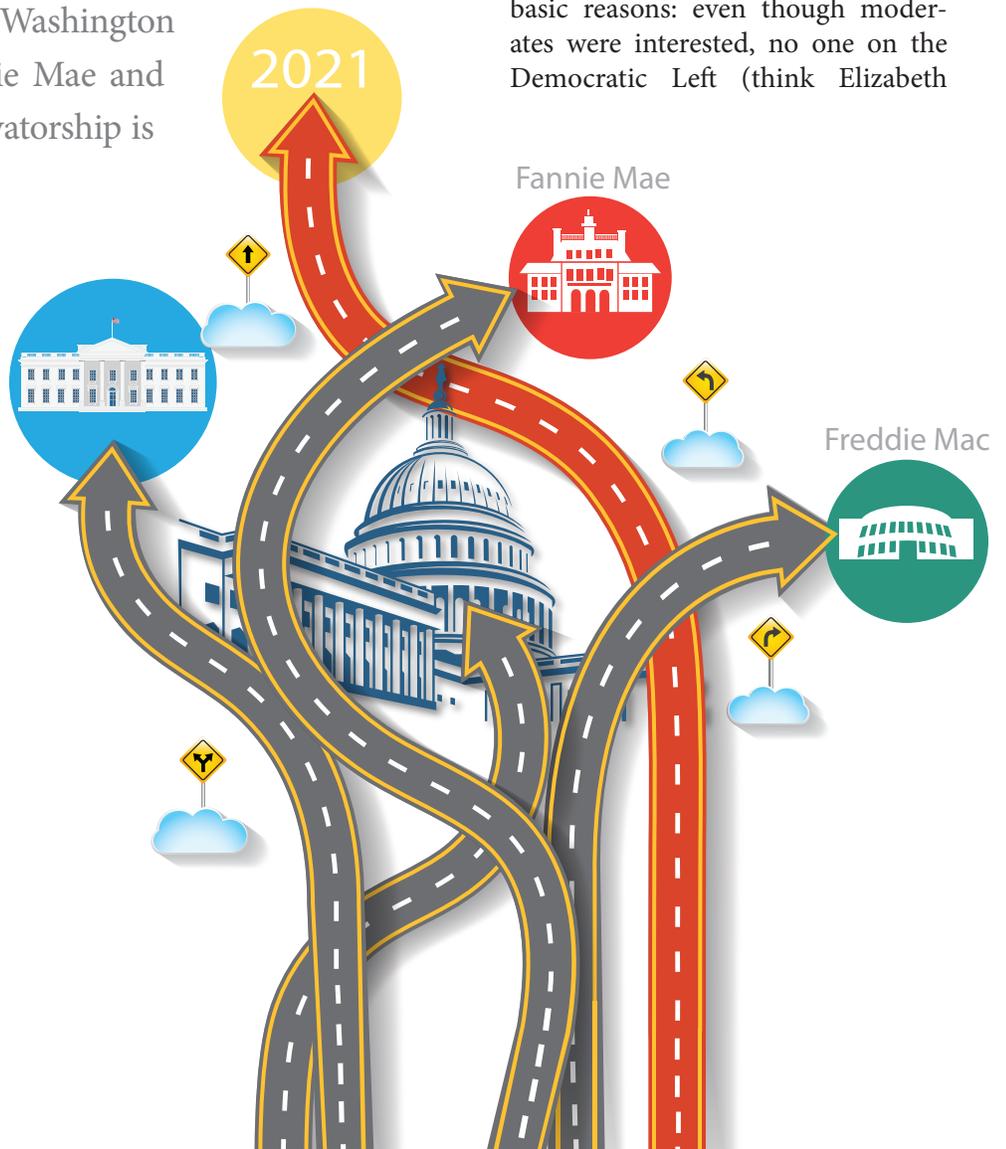
NO REFORM IN CURRENT CONGRESS

To find an answer, look at the broader landscape. The window has closed on any chances of a GSE reform bill passing in the 115th Congress. A draft bill circulated in the Senate in late January; although widely considered to be a viable first-cut at legislation that could actually move through Congress and reach the President's desk, it was ignored and quickly consigned to the back burner.

The bipartisan team responsible for the draft, Senators Bob Corker (R-TN) and Mark Warner (D-VA) designed the measure, in the words of

a senior Senate staffer, as a "centrist, non-ideological stab at fixing the issues surrounding GSEs. It will be simpler, more market-based, more focused on function over form."

In the end, it went nowhere for two basic reasons: even though moderates were interested, no one on the Democratic Left (think Elizabeth



Warren or Sherrod Brown) would support the bill because it did not sufficiently protect or expand affordable housing mandates. And the fact that it preserved a role for Fannie/Freddie meant that conservatives were unenthused.

OBSTACLES AHEAD FOR NEXT CONGRESS

Realistically, these same obstacles will remain for the 116th Congress that convenes in January after the November elections.

We will have a new chairman of the House Financial Service Committee. If the Democrats win a majority in the House, Rep. Maxine Waters (D-CA) will become chairman and housing finance reform will slide to the bottom of the agenda. If the GOP keeps the House, it is doubtful that any of the frontrunners to succeed outgoing Chairman Jeb Hensarling (R-TX) will make it the same priority that he did. After all, Hensarling's ambitious plans to reform the system failed in each of the last two Congresses.

On the Senate side, Republicans are expected to remain in the majority. That means Sen. Pat Toomey (R-PA) becomes chairman of Senate Banking. Toomey recently questioned the need for a government guarantee to ensure there is a liquid 30-year, fixed-rate mortgage market. And he has questioned the validity of the Fannie/Freddie dividend sweep in place at FHFA.

These two positions take Toomey outside the bipartisan consensus that has existed on the Committee. Realistically, this means he would need to either change his thinking or craft a new approach if he wants to advance legislation. As it's difficult to see how a Chairman Toomey could find common ground with Rep. Waters, the next Congress will be more about hearings and headlines than about substantive efforts to legislate on Fannie and Freddie.

TRUMP AND GSE REFORM

The next question is whether the Trump administration will attempt GSE reform next year. One of the few things that is certain is that FHFA Director Mel Watt's term is up in January, and the President seems interested in replacing him as quickly as possible.

Sources at FHFA say it's "virtually certain that Watt will leave on or slightly before his expiration date at FHFA," which is January 6, 2019. The thinking goes that Watt may try to name a deputy (similar to the Cordray situation at FHFA) as his replacement, but it's very unlikely the Administration would allow that to occur. A Republican Acting or permanent Director is likely to be waiting in the wings.

The Watt replacement will be a critical player in what comes next. Presumably a new FHFA Director will be in place by summer 2019, and the policies they pursue will be dictated largely by the political climate. At that point, the 2020 presidential primaries will only be seven months away, and it is unlikely that the White House will encourage its new FHFA Director to set a markedly new course that shakes up the housing market and thus loses votes for the President and his party.

Having said that, the new FHFA director—permanent or acting—will not be totally constrained. There are other steps to pave the way for future housing finance reform, such as:

- Suspending the payments to the affordable housing trust funds.
- Barring the GSEs from buying mortgages that were cash-out refinancings or that were for second homes.
- Freezing the conforming loan limit.



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All of this would be designed to help restart the private-label RMBS market. Yet none of it would be a solution to the Fannie/Freddie conservatorship.

HOUSING REFORM MAY WAIT

All of this points to 2021 as the next window for action for housing finance reform. Regardless of whether Republicans or Democrats control Congress and the White House, the prospects for big changes increase.

In the case of Democratic victory, look for legislation that expands affordable housing and restores Fannie and Freddie to pre-crisis roles, maybe with an enhanced government guarantee on mortgage-backed securities.

Under Republicans, something resembling the Mortgage Bankers Association plan could be implemented, where more securitizers and guarantors populate a new landscape, and a reduced government backstop is put in place.

If the outcome is divided government, Treasury would be in the driver's seat.

While the exact path forward three years from now can't be predicted with any certainty, there is likely to be renewed calls for reform. Between now and then, look for groundwork to be laid in both Congress and the Administration for future reforms. But don't expect large scale changes until after November 2020 resets the political system. ▲

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