Federal Reserve Bank of Cleveland

The Financing Players in Housing Policy

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Disclaimer

The views expressed are mine and not those of the Federal Housing Finance Agency.

Loan Terms

- Availability of subordinate liens—right of refusal for first lien?
- Availability of refinance loans—prepayment fees?
  - Net economic costs
  - Net increase in financial risk

Reconsider tax deductibility?

Servicing Model

- Timing of servicing payments poorly aligned with timing of costs
- Overreliance on reps and warranties

Cross Subsidies

- Low risk loans subsidize high risk loans at the Enterprises
- Loans from small lenders subsidize loans from big lenders

Implicit Guarantees—Private Market Option

Can we simply eliminate implicit guarantees without adding more explicit guarantees?

- Is FHA/GNMA enough to address low-income housing and first time (low FICO, high LTV) home buyers?
- Any reason to aid other borrowers?
  - Market efficiency vs. economic growth
- Market stability—Have investors learned enough lessons to avoid new housing bubbles for a long time?
- If they haven't, can the government price credit risk without subjecting itself to sizeable losses?
- Would the absence of government guarantees promote less risk-taking?
- Is multifamily housing an exception?
- Government role in standardization?

Selected Issues in GSE Design

- TBTF and systemic risk
- Concerns about cooperatives
- Government insurance funds and risk pricing
- Countercyclical capital requirements

New GSEs

Can We Design Inherently Safe GSEs?

- Less interest rate risk if asset portfolios are minimal
- Less credit risk if government takes the catastrophic portion and charges for it
- Even less credit risk if most of the rest of it is distributed to private investors

Possible Securitization Model (Example)

- All single-family MBS use senior/sub structure per Davidson
- Government guarantees senior piece, corresponding to cat risk, for a fee
- GSEs initially retain sub tranches (~2% of UPB?)
- Once a month or so, GSEs required to sell mega Subs without any guarantee
    - Aggregation by originator would facilitate market discipline
    - Aggregation by LTV/FICO could reduce cross subsidies
    - Broad aggregation would maximize liquidity

Other Possible GSE Features

- Market sales used to calibrate g-fee and cat risk pricing
- GSEs required to retain a small but significant portion (10%?) of sub tranches to help align GSE incentives with government
- Sub tranches must be capitalized at 100%
- GSEs retain total control of loss mitigation (including loan modification)
- Multifamily could remain closer to current model but more focused on securitization

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