

Proposed GSE Portfolio Limits Not Well Received by Housing Industry

By Michael J. Novogradac, CPA

Editor's Note: On May 25, after this article was written, the House Financial Services Committee advanced H.R. 1461 with an agreement that requires Fannie Mae and Freddie Mac to set aside 5 percent of their profits annually for housing grants to support primarily affordable housing rental production for very low- and extremely low-income families. The Federal Housing Finance Reform Act of 2005 will give regulators authority to direct the government sponsored enterprises (GSEs) to reduce their portfolios but does not set specific limits.

Federal Reserve Chairman Alan Greenspan's suggestion at an April 6 hearing before the Senate Banking Committee that Fannie Mae's and Freddie Mac's portfolios should be limited to no more than \$200 billion each has met with expected opposition from the housing industry.

Fannie's and Freddie's combined portfolios currently hold an estimated \$1.5 trillion. The Government Accounting Office (GAO) says that when the Federal Home Loan Banks' (FHLBs) holdings are included, the Government Sponsored Entities (GSE), as of year-end 2003, had collective obligations of \$4.6 trillion. The concern is that that because they are so large, financial problems at one or more of the GSEs could have destabilizing effects on financial markets.

Greenspan, Snow and Jackson Weigh In

"World-class regulation, by itself, may not be sufficient and, indeed, might even worsen the potential for systemic risk if market participants inferred from such regulation that the government would be more likely to back GSE debt in the event of financial stress," Greenspan said. "This is the heart of a dilemma in designing regulation for GSEs. We at the Federal Reserve believe this dilemma would be resolved by placing limits on the GSEs' portfolios of assets."

At a hearing the next day, before the House Financial Services Committee, Treasury Secretary John Snow and HUD Secretary Alphonso Jackson aligned themselves with Greenspan's suggestion to limit the GSEs' portfolios. Snow and Greenspan did not agree on how to restrict portfolio size, however; Greenspan advocated for allowing mortgages to amortize and not be replaced while Snow suggested the portfolio holdings be sold, with a gradual transition to a lower holding level.

Proposed legislation to regulate the GSEs, H.R. 1461 and S. 190, does not seek to impose specific portfolio limits; H.R. 1461 gives discretion to the regulator to limit portfolios, S. 190 does not.

Continuing his push for limiting the GSEs' portfolios, Greenspan, speaking on May 18 at the Conference on Housing, Mortgage Finance, and the Macroeconomy at the Federal Reserve Bank of Atlanta, said that "[t]he Federal Reserve Board has been unable to find any credible purpose for the huge balance sheets built by Fannie and Freddie other than the creation of profit through the exploitation of the market-granted subsidy.

"[I]n total, the assets required for Fannie and Freddie to achieve their mission are but a small fraction of the current level of their assets...if the Congress legislates a mission-only need for GSE portfolio assets, a substantial liquidation of MBS over time, coupled with an equivalent redemption of GSE debt, will doubtless be required," Greenspan said. "Such liquidation would entail not solely a removal of demand but an equal removal of both supply and demand for MBS. Accordingly, the implementation of portfolio limits should pose no significant difficulties...Even with smaller portfolios, Fannie and Freddie would remain formidable institutions and their profits would provide more than sufficient support for their special affordable-housing programs."

GSEs' Contributions to Multifamily Housing

While Greenspan's comments focused entirely on the GSEs' primary mortgage market activities and made no direct mention of the LIHTC, it is imperative that we note the role that the LIHTC plays in the GSEs' portfolios. Because the investments that Fannie and Freddie make in the multifamily affordable housing products are substantial, limiting their portfolios could have a chilling effect on the LIHTC industry.

Last year, Fannie and Freddie made more than \$40 billion in multifamily housing investments for 2004. Freddie Mac closed a record \$23.8 billion in new multifamily business transactions last year. This volume

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included approximately \$2 billion in targeted affordable housing products, which finance apartments that receive some form of government subsidy. That number was up from \$776 million in 2003. Freddie Mac's LIHTC investments topped out at \$1.3 billion in 2004. Its multifamily transactions financed approximately 450,000 apartment homes affordable to families earning low or moderate incomes.

Fannie Mae and its lender and housing partners invested \$21.2 billion in multifamily housing in 2004, which included debt financing through lender partners, and investments in LIHTCs through syndication partners. Fannie Mae's multifamily assets, comprised of multifamily mortgages purchased for cash, multifamily mortgage-backed securities (MBS), investments in LIHTC and other assets, total \$119.9 billion.

Richard Lawch, senior vice president of Fannie Mae's multifamily division, indicated that the company has no plans to slow the pace of its affordable housing investment and is preparing to provide even more units of affordable rental housing in 2005.

Nearly 90 percent of the multifamily units financed by Fannie Mae in 2004 are affordable to families at or below the median income of their communities. Approximately 54 percent of all multifamily units were reserved for special affordable (low- and very low-income units), and 45 percent of all loans were made in underserved markets and areas. Fannie Mae committed a record \$1.7 billion in multifamily equity investments that qualify for LIHTC, maintaining its position as the largest investor in LIHTCs.

Industry Reaction

At a hearing of the Senate Banking Committee on April 19, National Association of Home Builders (NAHB) president David Wilson declared the group's opposition to limiting the size Fannie Mae's and Freddie Mac's portfolios. "Specific portfolio limits are overreaching, unnecessary and could severely disrupt our mortgage markets," he said.

Similarly, National Association of Realtors (NAR) President Al Mansell's testimony opposed creating rigid statutory limits on portfolios. "NAR believes that portfolio limits should be regulated from a risk perspective, but opposes statutory limits for the sake of shrinking the GSE mission. We ask that Congress add safeguards to ensure that there are no artificial portfolio limits that weaken the GSEs' housing mission," Mansell said.

Office of Federal Housing Enterprise Oversight (OFHEO) director Armando Falcon told the Senate Committee on Banking, Housing and Urban Affairs that he believes the most prudent course of action would be for Congress to give the regulator explicit authority to regulate the size of the housing GSEs' portfolios, accompanied by specific statutory guidance on the exercise of such authority.

At the same hearing, Freddie Mac chairman & CEO Richard F. Syron defended the size of the GSE's portfolio. "Our portfolio helps support and fund our affordable housing activities. It allows us increasingly to subsidize our affordable programs. And some \$300 billion of our portfolio qualifies under one of our affordable housing goals," he said. ❖

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