How Fannie and Freddie Have Changed Since the Crisis

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The Treasury, led by Secretary Steven Mnuchin, said it would work to curtail Fannie and Freddie's role in housing finance. Photo: michael reynolds/epa/Shutterstock

The Trump administration said Thursday it would like to make big changes to Fannie Mae and Freddie Mac , FMCC -0.79% including pushing to release them from government control.

The Treasury, led by Secretary Steven Mnuchin, generally avoided specific policy recommendations. However, it said it would work to curtail the firms' role in housing finance while also developing plans to recapitalize the companies.

But the two mortgage giants have already quietly transformed in the decade since they were seized by the U.S. government during the depths of the financial crisis.

What Fannie and Freddie Do

Fannie and Freddie run the plumbing meant to make U.S. mortgages more readily available and affordable. The 30-year, fixed-rate mortgage, by far the most popular in the U.S., might not exist without them.

The firms don't make mortgages, but buy them from lenders, package them into securities to sell to investors, and provide guarantees to investors in case the mortgages go bad. The two firms guarantee nearly half of U.S. mortgages.

Returning the Money

Fannie and Freddie took a roughly $190 billion taxpayer bailout to help them stay afloat during the housing crisis. In 2012, the Obama administration said it would collect the firms' profits so the government could get repaid more quickly.

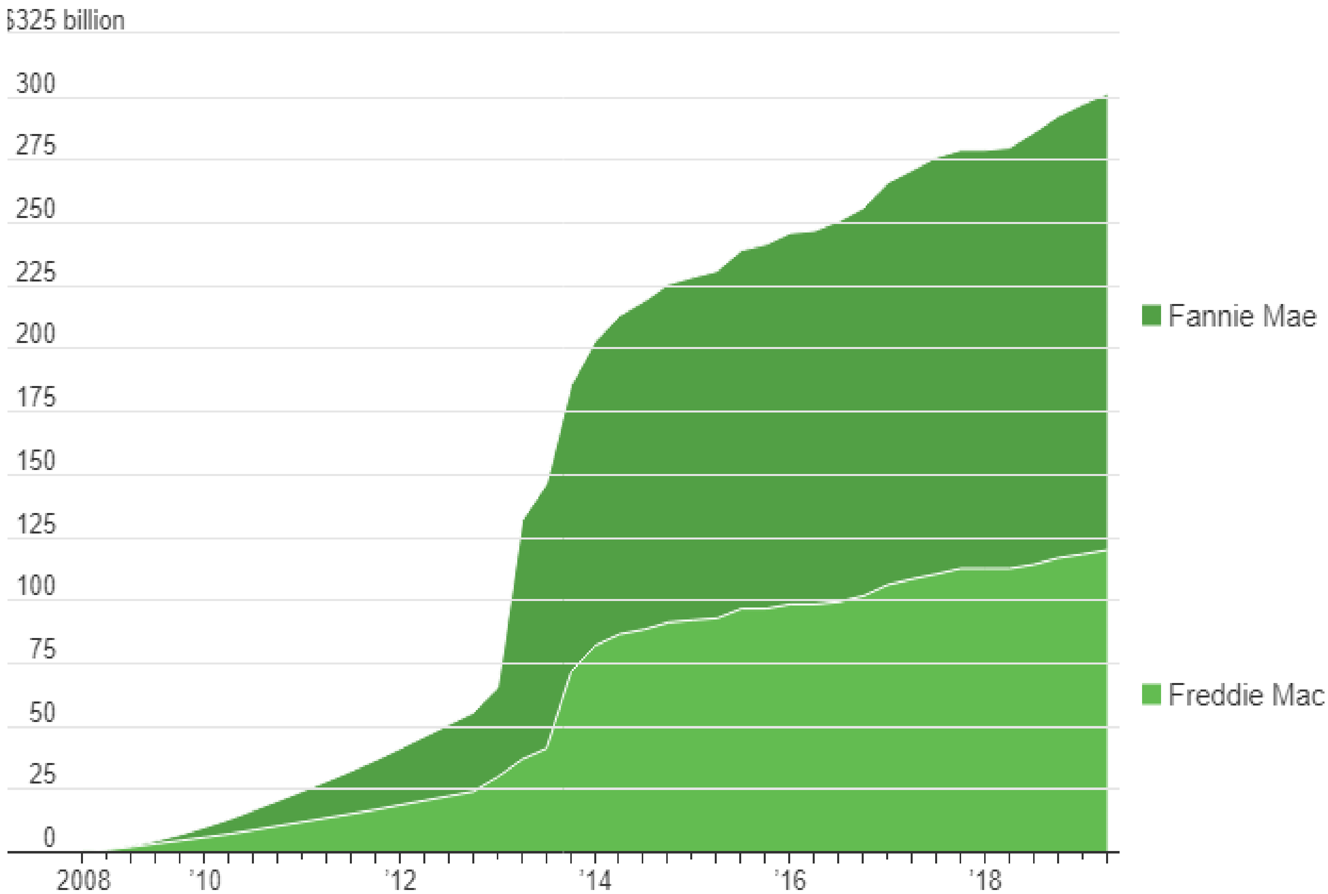
What changes in oversight, if any, do you think are appropriate for Fannie Mae and Freddie Mac? Join the conversation below.

The two firms now post billions of dollars in net income each year, aided by a bounceback in the housing market and the general economy. They also brought in more money by increasing the fees they charge lenders to guarantee mortgages—which had been very low before the crisis.

All told, Fannie and Freddie have sent more than $300 billion back to the government.

Cumulative amounts paid to Treasury Department, quarterly

Source: Federal Housing Finance Agency



Shrinking the Portfolio

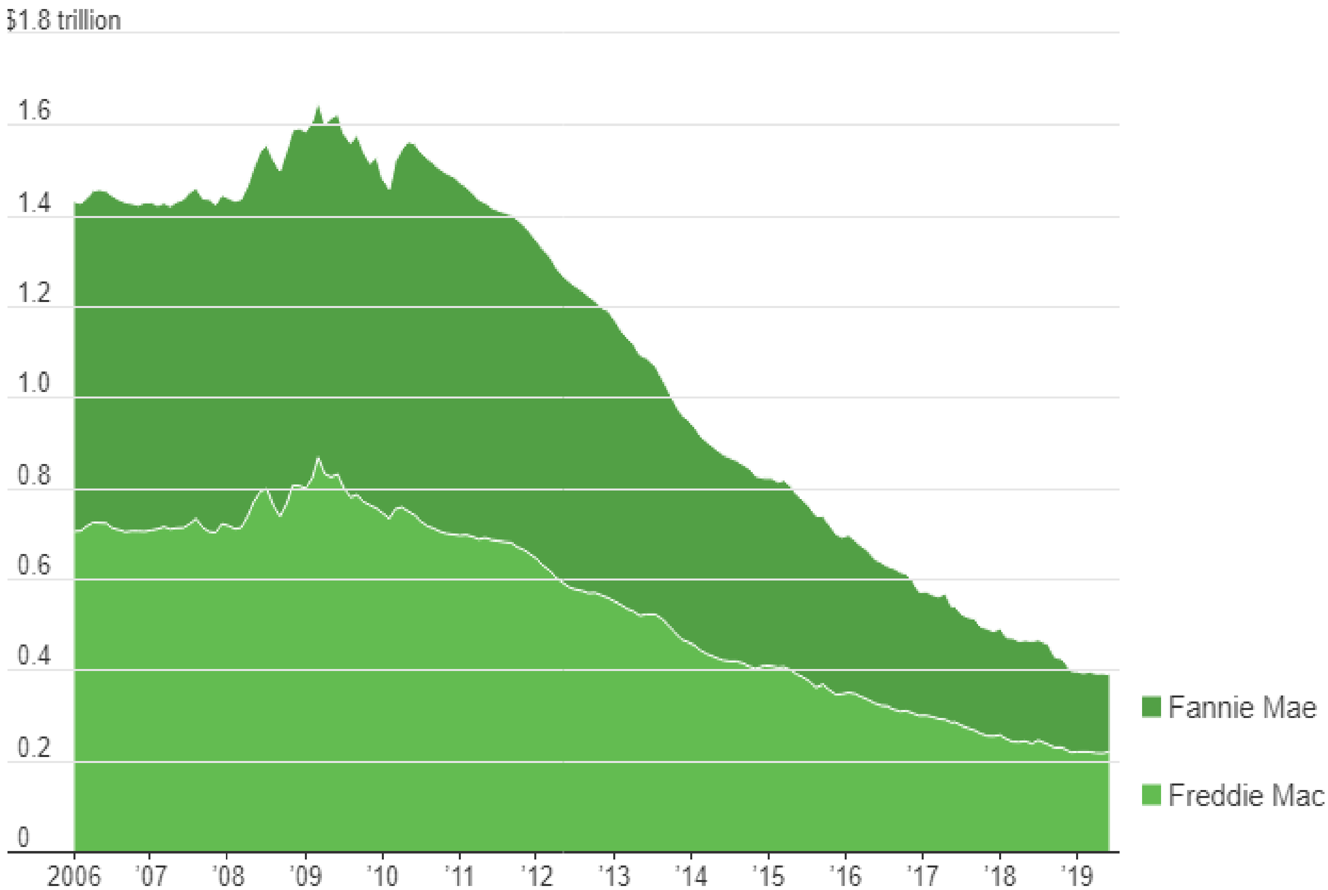
During the housing bubble Fannie and Freddie purchased large amounts of mortgages and mortgage-backed securities they kept on their books, which they funded by issuing debt. Each of their portfolios topped $800 billion at their peak.

As the housing market tanked, those so-called retained portfolios proved toxic, hastening the mortgage giants' fall.

After the crisis, Fannie and Freddie planned to shrink their retained portfolios to less than $250 billion apiece by the end of 2018. Both are now well below those levels.

Mortgage-related investment portfolios, monthly

Source: Urban Institute, Fannie Mae, Freddie Mac



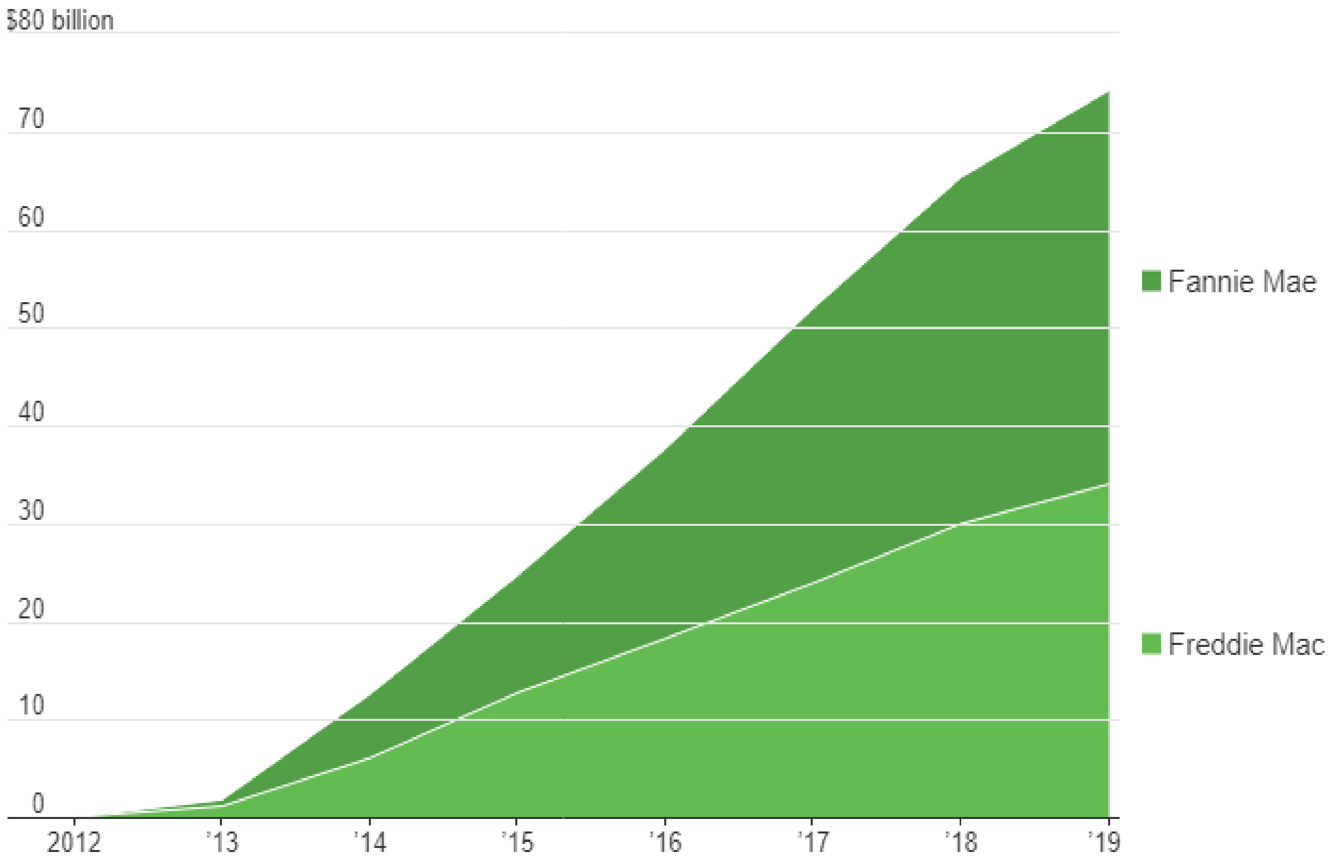
Shedding Credit Risk

Fannie and Freddie have also begun to hand off some of the risk in their bread-and-butter business of guaranteeing mortgages.

The two companies have together done more than $70 billion of so-called credit-risk transfers, where investors take on some of the risk of the mortgages defaulting. They have each unloaded risk on pools of mortgages totaling more than $1 trillion, according to the Urban Institute.

Cumulative issuance of credit-risk transfer securities, annually

Note: 2019 data are through July
Source: Urban Institute, Fannie Mae, Freddie Mac



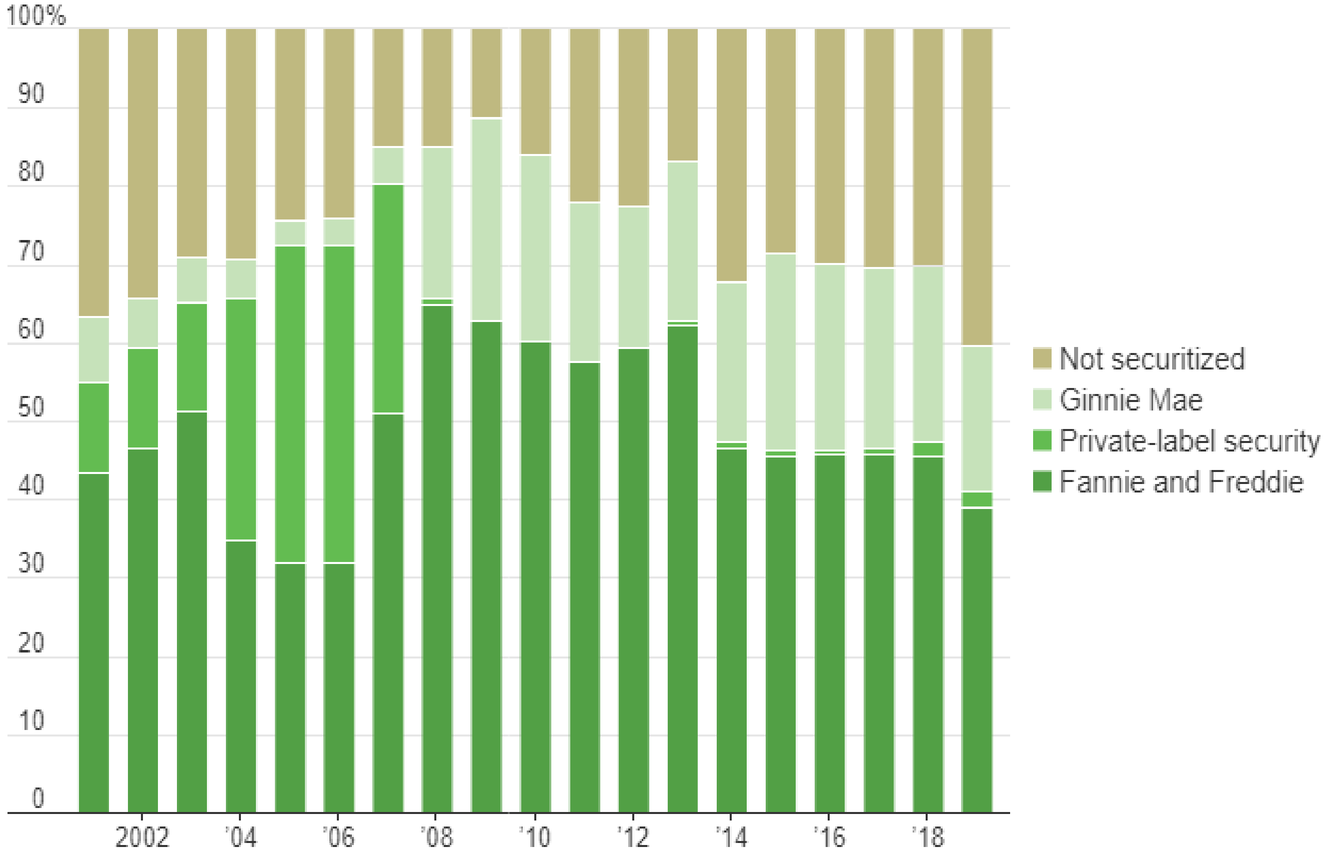
In the years before the financial crisis, Fannie and Freddie bought about a third of U.S. mortgages to package into securities. Many other mortgages went into private bonds.

But after those private bonds blew up during the financial crisis, investors shunned them and the market effectively evaporated. Instead, investors wanted Fannie and Freddie securities because they were perceived to have government backing.

Though their market share has been falling in the past few years, about 40% of mortgages ended up in Fannie and Freddie securities in the first half of this year.

Mortgage originations by investment type, annually

Note: 2019 data are through June.
Source: Urban Institute, Inside Mortgage Finance

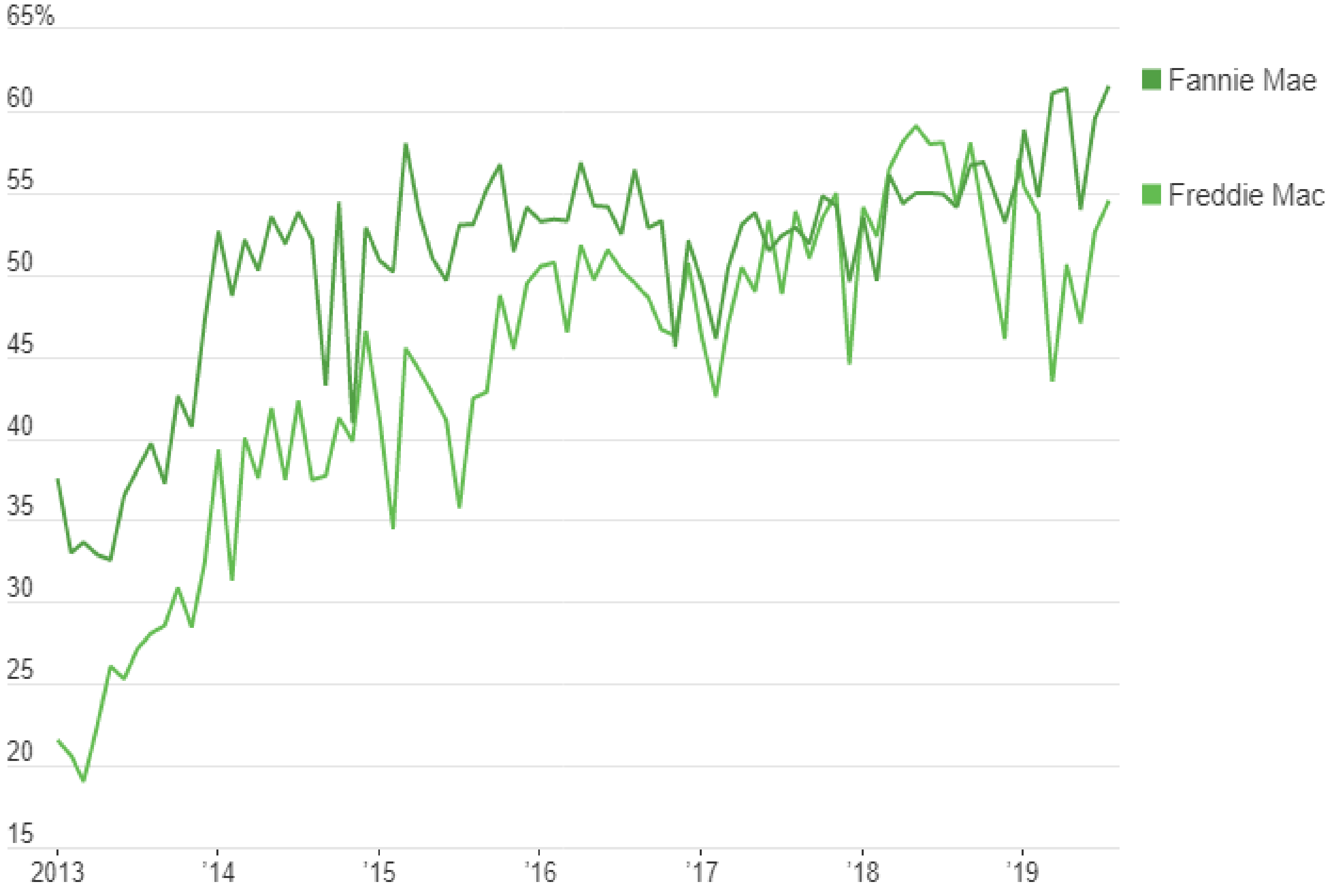


What Fannie and Freddie Look Like Now

Today, Fannie and Freddie look a lot like the mortgage market at large. Many of the mortgages they buy are made by nonbanks, which are less regulated than their bank counterparts. Many of the nonbank firms have yet to weather a housing downturn, and some regulators worry about their financial strength.

Share of mortgage originations by nonbank lenders, monthly

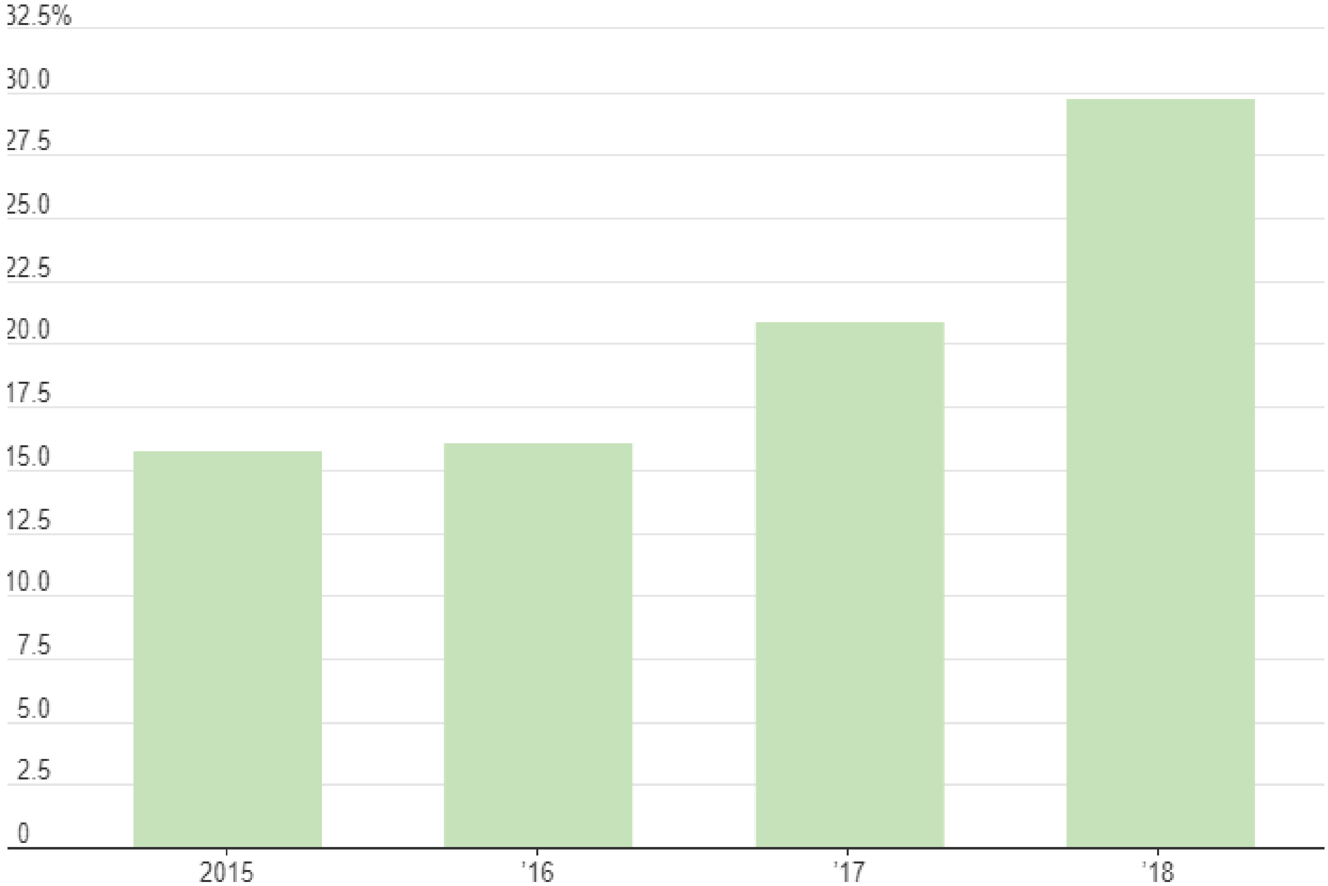
Source: Urban Institute, eMBS



As home prices have risen, buyers who use Fannie and Freddie programs are stretching further to afford a home. A who use Fannie and Freddie mortgages have monthly debt payments that make up more than 43% of their income, a threshold typically indicating a riskier mortgage.

Share of mortgages in Fannie and Freddie securities that have debt-to-income ratios above 43%, annually

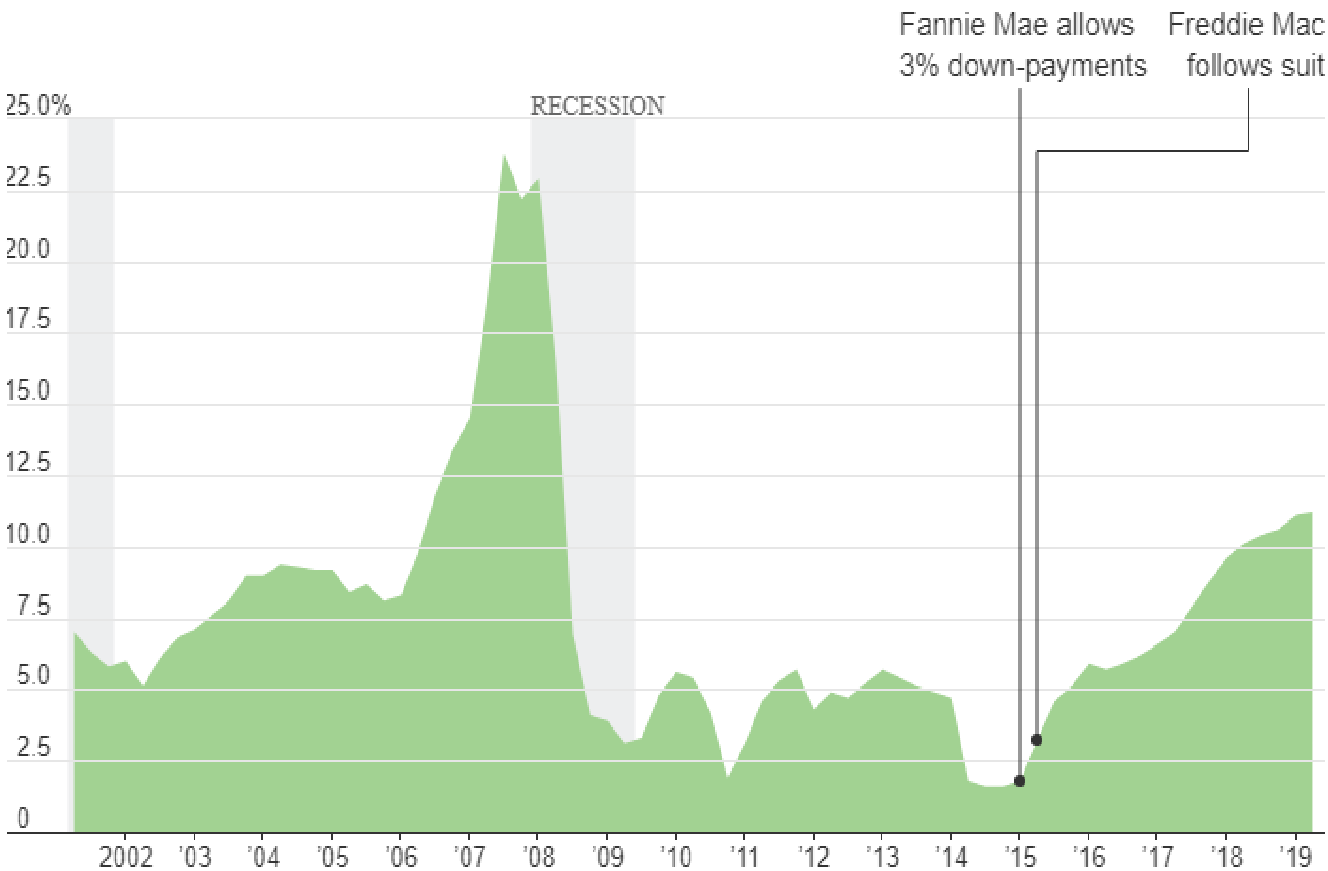
Source: Inside Mortgage Finance



More borrowers also use Fannie and Freddie programs that allow them to make a down payment of just 3%.

Share of Fannie- and Freddie-eligible loans with less than 5% down payments, quarterly

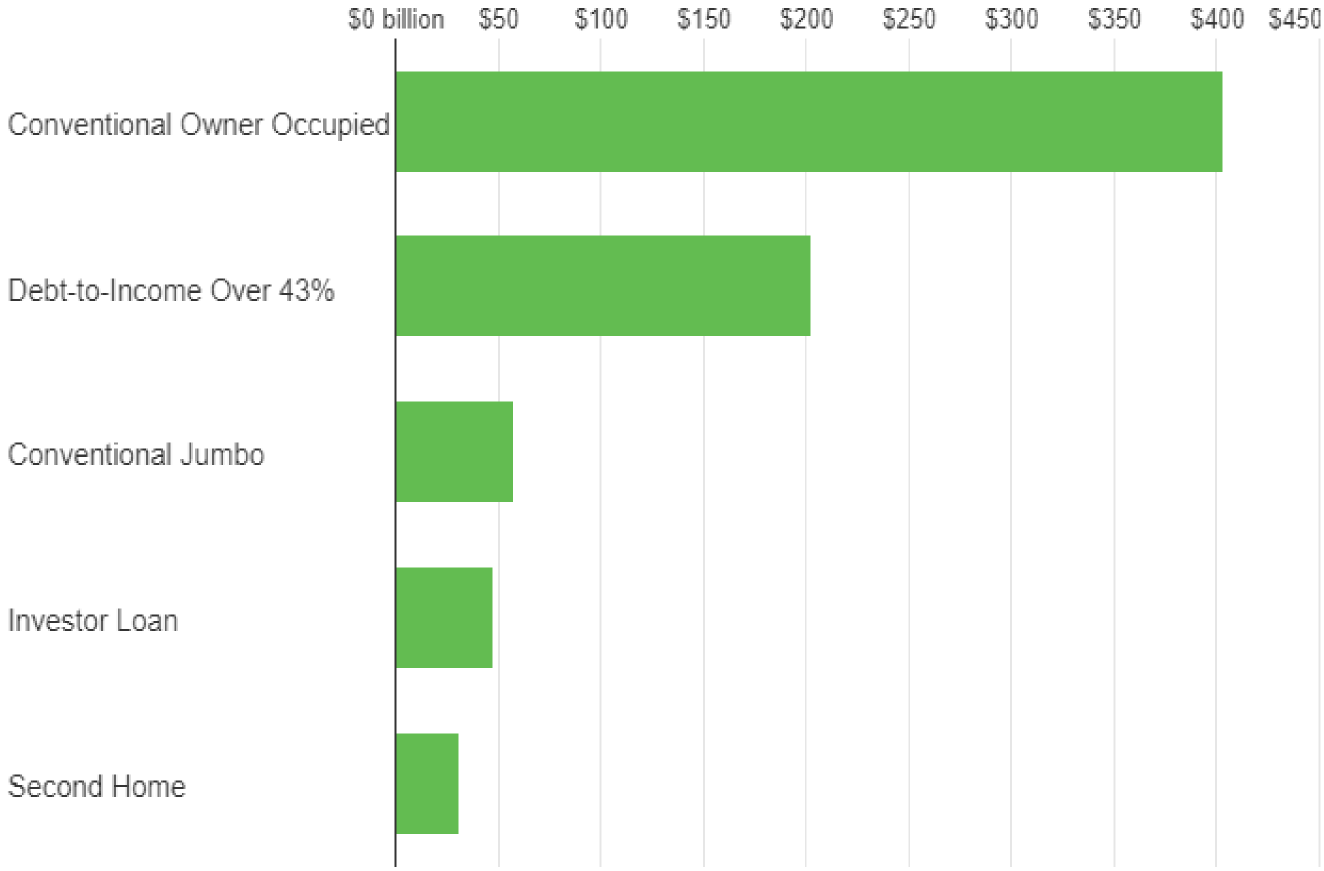
Source: CoreLogic



While Fannie and Freddie buy many conventional mortgages for individual borrowers, they also buy loans on investor properties and second homes. Some say those fall outside the core mission of the companies and should instead be pushed into the private market.

Fannie Mae and Freddie Mac mortgage origination in 2018 by type

Note: Original loan balances of fixed-rate mortgage-backed securities
Source: Annaly, Barclays



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