CAPITAL ALPHA PARTNERS

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MORTGAGE/HOUSING/GSES FLASH

Watt Green Lights Trust Funds, Further Complicating Drive To Phase Out Fannie & Freddie

- In letters to Fannie Mae and Freddie Mac this morning, FHFA Director Mel Watt terminated the agency's suspension of contributions from the Enterprises to the Housing Trust Fund and Capital Magnet Fund, which were mandated by the 2008 Housing and Economic Recovery Act (HERA). The contributions would be generated via a 4.2 basis point fee on "the unpaid principal balance of each company's new business purchases" effective with the January 1 start of their 2015 fiscal years -- with transfer of the moneys then required within 60 days after year-end. The move has been somewhat telegraphed by Watt, who first signaled his proclivity to finally green light the contributions in his "coming out" address at the Brookings Institute back in May. During a final Senate Banking hearing on Nov 19, Watt promised to announce his related decision in December.

- Meanwhile, the HTF will fund annual formula grants to states and state-designated entities, of which "at least 80 percent must be used for rental housing; up to 10 percent for homeownership; and up to 10 percent for the grantee's reasonable administrative and planning costs." The Capital Magnet Fund (perhaps ironically run by the Treasury Department), will "provide competitively awarded grants to community development financial institutions (CDFIs) and qualified nonprofit housing organizations...used to finance affordable housing activities as well as related economic development activities and community service facilities."

- We see at least two key takeaways from the move: First, in making the announcement, Watt formally declares that the GSEs are financially safe and sound, and unlikely to require another draw from the Treasury (the key reasons for suspension of the HERA-mandated contributions back in 2008). Secondly, and more importantly, he also gives Congressional Democrats and housing advocates much of what they've wanted from the Enterprises, namely funding support for affordable housing. Combined with increasing hope that Watt might announce reduced lender guarantee fees from the companies by the end of 1Q2015, both of these factors further mitigate against passage of housing

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finance reform legislation (which would force elimination of the GSEs' affordable housing goals) anytime soon. They thus have been an important element in our constructive view toward the long-term investment story relating to GSE common and preferreds.

- Though the Obama Administration is nevertheless made to seem as having newly reaffirmed its commitment to phase out Fannie and Freddie, while shareholders' earlier optimism about legal recourse remains at ebb, following a key federal court decision back in September, we continue to believe that the status quo will become increasingly indefensible. With the two companies continuing to generate remittances that boost federal coffers, while arguably imposing tougher-than-necessary credit constraints and co-existing with virtually no private capital cushions (putting taxpayers at unnecessary risk), we believe this could eventually prompt the next administration to either remove the GSEs from conservatorship and/or to revise the PSPAs in order to allow rebuilding of capital reserves. Meanwhile, along the way -- with the GSEs, via risk-sharing deals, increasingly playing a transformed role as conduits for private capital -- this just might allow eventual restoration of dividend payments to shareholders.

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