Treasury and FHFA Amend PSPAs to Allow GSEs to Retain Additional Capital

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Status in Conservatorship Won't Change; Likely a Low Impact on Mortgage Finance Stocks

WHAT YOU SHOULD KNOW: After the close on Thursday, Treasury and FHFA announced amendments to the Preferred Stock Purchase Agreements (PSPAs) with the GSEs, which allow Fannie Mae (FNMA, Not Covered) and Freddie Mac (FMCC, Not Covered) to build additional capital. The agreements permit the GSEs to retain capital up to their regulatory minimum of roughly $280 billion, or 4.3% of their combined $6.6 trillion in assets, versus the prior agreements from 2019 which permitted Fannie and Freddie to only retain up to $25 billion and $20 billion, respectively, before excess earnings were swept back to Treasury. However, Thursday's agreement also establishes that the GSEs cannot exit conservatorship with a capital ratio of less than 3%, and so we don't think the agreement helps meaningfully accelerate a near-term exit from conservatorship. Overall, we see it having a low impact on mortgage finance stocks, although we note the amendments also establish limits around the GSEs acquiring certain higher-risk loans, which we view as a modest incremental positive for lenders and aggregators including mortgage REITs.

- Treasury's amendments replace the net worth sweep by raising the liquidation preference of Treasury's preferred stock by the amount of retained capital at the GSEs. Treasury's combined senior preferred liquidation preference in the GSEs is currently $228.7 billion.
- At the end of September, Fannie had $21 billion in net worth, and Freddie had $14 billion (a combined capital ratio of about 50 bps), which implies it will likely take several more years before each has the opportunity to exit conservatorship. Additionally, the agreements on Thursday establish that the GSEs can raise up to $70 billion each in new stock, but only after Treasury exercises its warrants to acquire up to 79.9% of common stock, *and* after all material litigation related to conservatorship gets resolved or settled. In December, the Supreme Court heard arguments related to the constitutionality of the net worth sweep, including whether the President has the power to unilaterally remove the FHFA Director.
- The new agreements also cap at current levels the percentage of certain higher-risk mortgage loans that can be acquired by the GSEs, including loans secured by second homes and investment properties. We see those cohorts being attractive potential sources of longer-term growth for lenders such as mortgage REITs (we note **NLY** (Buy, $9) and **CIM** (Neutral), for example, have been active in recent years aggregating and financing Agency-eligible investor loans through securitization). Treasury's agreements don't necessarily expand the market share available for REITs, although at the same time, it likely helps stymie any additional GSE support those loans could have received under the incoming Administration.

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