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Fannie-Freddie Investors Cheer Trump on Hopes of Policy Changes

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Shares of Fannie Mae and Freddie Mac surged at the open as investors in the mortgage-finance giants speculated that a Donald Trump presidency might reverse years of policy geared toward wiping out their investments.

Fannie Mae shares rose 13 percent to \$1.87 at 10:33 a.m. Freddie Mac climbed 15 percent to \$1.78. Shares of some classes of Fannie Mae and Freddie Mac preferred shares were up more than 8 percent. The spikes were in sharp contrast to the S&P 500, which was flat.

The morning after Trump's victory over Democrat Hillary Clinton, some analysts said the Republican's election could open the door to changes to longstanding policies surrounding the companies, which back just under half of the mortgage market. What's less clear is what those changes will be, as Trump's close association with some Fannie Mae and Freddie Mac shareholders could be put up against Congressional Republicans still dead-set on eliminating the companies.

Fannie Mae and Freddie Mac don't make mortgages. They buy them from lenders, wrap them into securities and guarantee repayment principal and interest to investors.

Bailout Money

The government took control of the companies during the 2008 financial crisis, eventually injecting them with \$187.5 billion in bailout money. It left the companies' original shares outstanding, and in the past few years they have been the subject of a political battle and lawsuits over their futures.

"This has to open the door for the government to return Fannie and Freddie to private ownership," wrote Cowen & Co. managing director Jaret Seiberg in a note to clients on Wednesday. Seiberg said Trump's victory likely won't return them to a duopoly but rather to private status with competition from other companies.

While Trump never addressed housing-finance reform on the campaign trail, the Republican Party platform called the mortgage companies a "corrupt business model" and said "the utility of

both agencies should be reconsidered as a Republican administration clears away the jumble of subsidies and controls that complicate and distort home-buying.”

Some major supporters of Trump and the Republicans also are Fannie Mae and Freddie Mac shareholders. Hedge fund manager John Paulson of Paulson & Co. was named to Trump’s economic policy team in August. His is among a group of hedge funds that have spent millions of dollars lobbying Congress and running a public-relations campaign seeking to realize value from their investments in the two mortgage companies.

Multi-year Lawsuits

Bruce Berkowitz, who runs mutual fund company Fairholme Funds Inc., said he would support Trump in a CNBC interview in September. Fairholme and other shareholders are in the midst of multi-year lawsuits against the U.S. government alleging that a 2012 change in the government’s bailout agreement with Fannie Mae and Freddie Mac was illegal.

The government has fought not only the lawsuits but the disclosure of documents that the shareholders believe will help their cases. A new White House could change that litigation tactic.

On the other hand, the Republican Party’s victory on Tuesday also puts more power in the hands of some of the most vocal proponents of eliminating the companies. Representative Jeb Hensarling, the Texas Republican who leads the House Financial Services Committee, authored a bill that would phase out Fannie Mae and Freddie Mac within five years, leaving shareholders’ fate uncertain.

Legislative Train

“I don’t see Hensarling caving. He’ll still be driving the legislative train on this,” said the Cato Institute’s Mark Calabria, who was a former staff member for Alabama Republican Richard Shelby, the outgoing chairman of the Senate Banking Committee. “I’m not sure this is really a big win for shareholders, as I don’t see Trump himself getting into the weeds” on issues related to Fannie Mae and Freddie Mac, Calabria said.

Tennessee Senator Bob Corker in 2014 helped lead a bipartisan effort to wind down Fannie Mae and Freddie Mac and replace them with a new system. That bill never reached the Senate floor amid opposition from some Democrats. That same bill was co-sponsored by Idaho Republican Senator Mike Crapo, who is likely to take the helm of the Banking Committee.

Corker also spearheaded an effort late last year that could block Trump from releasing Fannie Mae and Freddie Mac unilaterally. As part of a broader spending bill, Congress passed a provision that forbids the Treasury Department from disposing of its stake in Fannie Mae and Freddie Mac before 2018.

Progressive Groups

Uncertain is what form a new housing-finance reform push could take. Housing advisers to Clinton had advocated merging Fannie Mae and Freddie Mac into a single, government-owned corporation. Some progressive groups, small lenders and current shareholders have fought to turn the companies into utilities, with a strong capital buffer and capped rate of return.

As President Barack Obama leaves office, some affordable housing groups may make an effort to convince the administration to help strengthen Fannie Mae's and Freddie Mac's role in the housing market. That could include allowing the companies to build capital reserves and strengthening their mandates to serve low-income borrowers responsibly, said John Taylor, president of the National Community Reinvestment Coalition.

"It's too late to actually do something that would take them out of conservatorship because they haven't allowed them to build capital reserves," said Taylor. "But it's not too late to create a path out of conservatorship."

A Treasury Department spokesman declined to comment.

"The election of Trump and the prominence of several of his supporters in favor of compensation for GSE shareholders could set up a direct conflict with a newly empowered Republican Congress, should they choose to pursue housing finance reform," wrote Brandon Barford, a partner at Beacon Policy Advisors LLC in Washington in an e-mail.