Fannie Mae and Freddie Mac now appear to be here to stay. How exactly did that happen?

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When the federal government announced earlier this week that it would allow **Fannie Mae** and **Freddie Mac** to rebuild a portion of their capital reserves to a total of $45 billion combined as part of a plan to exit conservatorship, the message was clear: The government-sponsored enterprises are back and they're not likely to go away any time soon.

It's a dramatic reversal from where things stood just a few years ago, when the prevailing sentiment in Washington, D.C. was how to get rid of the GSEs, once and for all.

In fact, there were numerous Congressional efforts that would have seen the GSEs wound down within five years.

And, if one of those bills had passed in 2015 (as was certainly a possibility), the GSEs likely would be in their last year of existence as we speak.

Instead, the GSEs appear primed to exit conservatorship on stable footing with healthy financial backing and reformed operations. So, how exactly did we get here?

Let's start at the beginning, so to speak.

Fannie and Freddie were taken into conservatorship in September 2008, with the government providing each of the GSEs with hundreds of billions of dollars in financial support in order for the companies to survive the housing crisis.

The fact that they had to be put into conservatorship at all was, at least somewhat, of their own making. Both companies, which buy and securitize mortgages, were buying riskier and riskier mortgages in a race to increase profits.

That house of cards eventually toppled, leading the government to step in and begin overseeing their operations.

Now, some argue that that move was unnecessary, claiming that the GSEs were on much more stable footing than the government portrayed them to be.

Putting those claims to the side for a moment (federal courts are still deciding whether or not they have merit), the GSEs were taken into conservatorship, and many feared the companies wouldn't survive the economic downturn.

New management was eventually put in place at both of the GSEs, with Donald Layton taking over at Freddie Mac in 2012, and Tim Mayopoulos assuming the role of CEO of Fannie Mae in the same year.

Both CEOs were tasked with getting the GSEs back on solid ground and were supported in that mission by both the Obama administration and the **Federal Housing Finance Agency**, under the leadership of Obama-pick Mel Watt.

The Obama administration seemed content with the status quo at the GSEs, allowing them to rebuild business and send profits to the **Department of the Treasury** to pay back the bailouts given to the companies during the crisis.

Under the terms of the Preferred Stock Purchase Agreements that went into effect when the government took the GSEs into conservatorship, Fannie and Freddie send dividends to the Treasury each quarter that they are profitable.

That wasn't the plan initially. Early on in conservatorship, the GSEs only sent a percentage of their profits to the government. But that all changed with the "Third Amendment Sweep," which stipulated that the GSEs send their entire profit margin to the Treasury each quarter.

Over the years, many observers have questioned whether it was necessary for the federal government to modify its conservatorship agreement with Fannie and Freddie to sweep all the profits from the GSEs into the government's coffers, an arrangement referred to as the "Third Amendment Sweep" or the "Net Worth Sweep."

At the time, the government claimed the GSEs were on the brink of collapse, and amended the terms of the GSEs' conservatorship to ensure that the government had enough money to bail them out again if necessary.

In the aftermath, a series of Fannie and Freddie shareholders sued the government, claiming the "Third Amendment sweep" was not only unnecessary but illegal as well.

As stated earlier, those claims are still being adjudicated, but for the most part, the Obama administration and Mel Watt's FHFA appeared comfortable with allowing the GSEs to rebuild and regrow their businesses.

That's not to say that Watt didn't talk a good game and even walk the walk sometimes when it came to GSE reform. There were many occasions when Watt pushed Congress for GSE reform, and Watt did oversee the construction of the single security, a joint mortgage-backed security that is now being issued by both Fannie and Freddie.

Meanwhile, the GSEs were operating as though they had no plans of disappearing.

Each GSE grew its share of the mortgage market to massive proportions, aided, some argue, by the Qualified Mortgage Patch, which allows the GSEs to buy and back loans that have debt-to-income ratios beyond the industry standard of 43%.

The GSEs also both began backing loans to borrowers with as little as 3% down, encroaching on buyer territory that was long dominated by the **Federal Housing Administration**.

Each of the GSEs also revamped their operating models, leading each to turn profits in nearly every quarter for the last 10 years.

But all that was happening with the GSEs seemingly sitting on a ticking time bomb.

Under the PSPAs, the GSEs were prohibited from rebuilding capital and each of the GSEs' capital base was required to be reduced over time, eventually leading to the GSEs having no capital base at all on Jan 1., 2018.

That all changed when the FHFA announced late in 2017 it was modifying the PSPAs to allow Fannie and Freddie to hold $3 billion to "cover other fluctuations in income in the normal course of each Enterprise's business."

Later that year, the GSEs officially withheld some of their profit and rebuilt a very small portion of their capital reserves.

But Watt's term as FHFA director ended earlier this year, allowing the Trump administration to fully establish its point of view on GSE reform.

The Trump administration replaced Watt with Mark Calabria, who previously served as chief economist for Vice President Mike Pence. Prior to serving as Mike Pence's chief economist, Calabria served at the **Cato Institute** and has long been an advocate for housing finance reform.

As Pence's economist, Calabria famously called for the end of the conservatorship of Fannie Mae and Freddie Mac.

And with Calabria and other officials in the fold, the Trump administration took basically the opposite approach of its predecessors on GSE reform, in both words and actions.

Treasury Secretary Steven Mnuchin, for example, said the Trump administration was committed to ending the GSE conservatorship, a sentiment echoed by Calabria.

The rest of the administration, meanwhile, formally called for the end of conservatorship on several occasions.

Then, last month, the Trump administration released its sweeping housing finance reform plan that calls for Fannie and Freddie to be privatized, which Calabria has long indicated is the plan.

And, finally, earlier this week, the government announced that it would allow the GSEs to retain $45 billion in capital, further setting the stage for them to exit conservatorship.

The move all but ended the net worth sweep, at least until the GSEs build up their allowable capital reserves.

Under the agreement between the GSEs, the Treasury and the FHFA, Fannie Mae can now hold a capital reserve of $25 billion, while Freddie Mac can hold $20 billion.

Those figures are obviously a sizable increase from what the GSEs used to be able to hold ($3 billion each) and even bigger jump from where they were supposed to be right now (capital reserves of $0 each).

But given the GSEs' place in the mortgage market now, the moves are viewed by those involved as necessary.

"The enterprises are leveraged nearly 1,000-to-one, ensuring they would fail during an economic downturn – exposing taxpayers once again," Calabria said earlier this week. "This letter agreement between Treasury and FHFA, which allows the enterprises to retain capital of up to $45 billion combined, is an important milestone on the path to reform."

Mnuchin also said the move puts Fannie and Freddie on a path to being released from conservatorship.

"These modifications are an important step toward implementing Treasury's recommended reforms that will define a limited role for the federal government in the housing finance system and protect taxpayers against future bailouts," Mnuchin said.

Under the terms of the new agreement, Treasury's liquidation preferences for its Fannie Mae and Freddie Mac preferred stock will "gradually increase by the amount of the additional capital reserves until the liquidation preferences increase by $22 billion for Fannie Mae and $17 billion for Freddie Mac," the department said in an announcement.

That increase in liquidation preference is to "compensate Treasury for the dividends that it would have received absent these modifications."

Beyond that, the agreement also hints at further recapitalization:

Treasury and each of Fannie Mae and Freddie Mac also agreed to negotiate an additional amendment to the PSPAs that would further enhance taxpayer protections by adopting covenants that are broadly consistent with the recommendations for administrative reforms contained in the Plan.

The Plan also recommended that Treasury and FHFA develop recapitalization plans for Fannie Mae and Freddie Mac after identifying and assessing the full range of strategic options. Subsequent amendments to the PSPAs may be appropriate to facilitate the implementation of any eventual recapitalization plans.

Calabria has acknowledged that fully removing the GSEs from conservatorship can't be done without Congressional action, but given the difficulty of getting that done quickly, the Trump administration is taking action to put the GSEs on the path to being private companies again.

This week's move to allow Fannie and Freddie to keep some of their profits was a big step in that direction.

And given the events of the last few months, it looks like that train isn't slowing down any time soon. The destination? Fannie and Freddie alive and well and operating as private companies.

That's a far cry from how things looked just a few years ago. How times have changed.