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Fannie Sees a Way to Repay Billions

By: Nick Timiraos and Alan Zibel – March 18, 2013

The rebounding housing market has helped return Fannie Mae to profitability and now might allow the government-controlled mortgage-finance company to do the once unthinkable: repay as much as $61.5 billion in rescue funds to the U.S. Treasury.

The potential payment would be the upshot of an accounting move that Fannie Mae's senior executives are looking to make whereby the company would reclaim certain tax benefits that were written down shortly after the company was placed under federal control in 2008. The potential move was disclosed last week in a regulatory filing in which the company said it would delay the release of its annual report, due by Monday, as it tries to reach resolution with its accountants and regulator over the timing of the accounting move.

The debate about when Fannie should be allowed to reclaim the so-called deferred-tax assets comes as Fannie and its smaller sibling, Freddie Mac, are likely to show large profits in the coming quarters as the housing market gradually recovers from a prolonged bust, home prices rise and mortgage delinquencies fall.

The potential payment also has political implications as lawmakers and regulators wrangle over the fate of the firms, which were placed into a federal conservatorship amid soaring losses. The Obama administration has publicly said the two companies eventually would be wound down and has blocked them from retaining profits, but has done little to de-emphasize their role in the mortgage market.

A spokeswoman for the company's regulator, the Federal Housing Finance Agency, declined to comment.

While a payment wouldn't erase its debt to taxpayers or remove it from government control, Fannie said in its filing that the accounting change would result "in a significant dividend payment" to the U.S. Treasury. The payment would flow straight to the Treasury, and the company could be able to repay the bailout funds it extracted from the Treasury sooner than many observers expected.

At issue are the credits and deductions a company can retain and use to defray taxes on its future profits. The assets must be written down if a company believes it won't be able to generate enough taxable income soon enough to use the credits. Fannie had recorded a total of $61.5 billion in write-downs of deferred-tax assets as of Sept. 30, 2012, virtually all of the assets' value.

Now, Fannie may be able to reverse some or all of those losses if the company concludes it is likely to have taxable income. Fannie reported $9.6 billion in net income for the first three quarters of 2012, compared with losses of $14.5 billion for the same period in the previous year. The company has said it plans to report a significant profit for the fourth quarter, which is expected to mark its largest ever annual profit and its first in six years.

For its part, Freddie said in its annual report that the conditions facing the company didn't warrant reversing any of its $31.7 billion in tax-asset write-downs as of the end of 2012.

Jim Vogel, an analyst who covers the companies at FTN Financial, said it is likely the companies would eventually be able to reverse some but not all of their deferred-tax write-downs.

Even though the potential payment results largely from a bookkeeping change, the prospect of Fannie remitting billions of dollars to the Treasury "could have important repercussions for reform and other housing-finance discussions," Mr. Vogel said.

Critics of the companies said they are worried that such a large payment to the Treasury would exaggerate their financial health and could remove the incentive to replace or wind down the firms. "While not truly representing a marketable asset, Fannie is likely to present its tax losses as a financial gain and use it as proof that they have turned the corner and should be allowed to continue as a company in their current state," said Mark Calabria, director of financial regulation studies at the libertarian Cato Institute.

Meanwhile, there are signs that Congress is starting to pay attention as worries that the firms would long remain a drain on the U.S. Treasury have given way to a new issue: that the companies' revenue stream might be used to pay for government spending amid efforts to reduce deficits.

Last week, four U.S. senators—two Democrats and two Republicans—introduced a measure that would bar lawmakers from using the firms' revenues to pay for unrelated government expenses. The bill would also require Congress to vote on any plan by the Obama administration to sell any of the Treasury's senior preferred shares in the firms.

When Fannie and Freddie were seized in 2008, the government agreed to inject the firms with cash to keep them solvent and took senior preferred shares in the firms in exchange for that backing. Under the terms of a revamped agreement reached last summer, any profits at the end of each quarter are swept away as a dividend payment on those preferred shares.

So far, Fannie and Freddie have received nearly $188 billion from the U.S. Treasury and they have paid dividends of $58 billion, bringing the total cost of their rescues to $130 billion, with around $88 billion for Fannie and $42 billion for Freddie.