

Questions Grow Along with Ginnie's Portfolio

BY BETTY JOYCE NASH

The housing market may still be in recovery, but the Government National Mortgage Association's business is booming. That growth has led some to question whether it will be able to remain stable over the long run.

Ginnie Mae, as the government agency is known, guarantees mortgage-backed securities issued by approved private lenders and composed of federally insured or guaranteed loans. Through November 2009, Ginnie had guaranteed about \$407 billion in mortgage-backed securities, compared to \$246 billion over the same period in 2008. Most of its collateral consists of mortgages insured by the Federal Housing Administration (FHA). While the FHA doesn't make loans, it insures lenders against defaults on loans that meet its standards. The loans are then sold on the bond market.

The volume of FHA loans has grown since 2008 as private lenders have retreated from risk. The FHA alone has insured 75 percent more loans in fiscal 2009, which ended Sept. 30, than the previous year. The FHA helps low- and moderate-income families who might not meet conventional standards buy homes by lowering loan costs. Down payments can be as low as 3.5 percent.

But as Ginnie's portfolio grows, more of these government-insured mortgages are defaulting, prompting some to believe that Ginnie will need help, too, just as Fannie Mae and Freddie Mac have been sustained by a credit line from the U.S. Treasury and a commitment by the Fed to buy up to \$1.25 trillion of GSE debt and mortgage-backed securities. It's unlikely that the Fed will hit that ceiling.

Ginnie Mae and Fannie Mae were offspring of the Federal National Mortgage Association, formed in 1938 to guarantee Uncle Sam's mortgages. Fannie was designed to serve conventional loans and Ginnie to support the market for FHA, Veterans Affairs, Office of Public and Indian Housing, and U.S. Department of Agriculture Rural Development Housing and Community Facilities Programs. When Fannie Mae was spun off from the federal government in 1968, its activities went off the federal government's balance sheet. Freddie Mac, formerly the Federal Home Loan Mortgage Corporation, shortly thereafter also became a publicly traded, shareholder-owned corporation in 1989.

The idea behind all three entities was to create a national — and global — market for housing capital by selling bundled mortgage loans on the secondary market. That allows lenders to free up cash for more loans. (On the flip side, however, if investors weren't buying securities, they might place their funds in banks, which could then lend that money.) But the government-sponsored enterprises, Fannie and Freddie, also held on to more mortgages in their own portfolios, according to the U.S. Government

Accountability Office. That exposed them to interest rate risk on outstanding debt.

However, Ginnie Mae retains no such portfolio of mortgages. Nearly all (more than 95 percent) of Ginnie Mae-guaranteed loans wind up in pools of securities, but a small percentage could be held in a lender portfolio or securitized through another entity such as Fannie or Freddie, according to a Ginnie Mae spokesperson.

Ginnie has sustained itself financially, and so has the FHA. But some observers worry about FHA default levels. Delinquency rates for FHA loans grew by 1.4 percentage points between third quarter 2008 and the same period of 2009, according to the Mortgage Bankers Association. By comparison, the rate had not changed this time last year, between third quarter 2008 and the same quarter 2007.

FHA-insured loans represent 18 percent of all mortgages originated, up from 4 percent two years ago. But as the FHA's share has been growing, its capital reserve has not. And the FHA's recently released actuarial study found its capital reserve ratio to be 0.53 percent, below the 2 percent threshold required by law. An independent actuarial study released in November says reserves fell to \$3.6 billion as of Sept. 30, down 72 percent over 2008. However, the FHA has \$30 billion in 30-year-reserves, according to the study.

A recent Inspector General's report in September faulted the FHA for its lack of controls over lender approvals. The FHA also failed to obtain or consider negative information on lenders from other Housing and Urban Development offices, and to make sure supporting documents and application fees were collected. Despite approving triple the number of lender applications in fiscal 2008 as in 2007, the FHA staff has remained constant. The Inspector General report cited oversight as a significant problem.

For its part, the FHA has announced an expansion of risk management efforts. For example, the agency is using more extreme scenarios in its models, including ones in which reserves drop below zero. And the FHA has tightened underwriting standards on refinancing and beefed up lender oversight. Borrower credit scores have improved too. The average FICO score today is 693 compared to 633 two years ago.

In addition to providing a boost to the mortgage market, Ginnie Mae securities ("Ginnies") have become an attractive investment option with commercial banks. That's because there has been a flight to security occurring in the overall credit markets, says economist Tony Plath of the University of North Carolina at Charlotte. The government guarantee mitigates investor risk and Ginnies offer a better yield than Treasuries. And banks have used Troubled Asset Relief Program money to buy Ginnies, Plath notes. Total bank holdings of Ginnies rose from around \$40 billion to \$120 billion between midyear 2008 and 2009. **RF**