

The Delaware Bay Company LLC

"Let the people know the facts . . . and the country will be safe." - A. Lincoln

HINDESight™ October 29, 2021

It's time.

THERE IS NO LEGITIMATE REASON TO CONTINUE HOLDING FANNIE MAE AND FREDDIE MAC IN CONSERVATORSHIP.

***The taxpayer has already been the beneficiary of
the best deal since the Louisiana Purchase.***

Declare victory!

This morning's third quarter earnings reports from **Fannie Mae** and **Freddie Mac** should put the last nail in the coffin for anyone who still believes the two companies should continue in what has become one of the longest conservatorships in history. (At this point, tied with **Britney Spears!**) Both reported strong earnings and increasing capital. So much so that as it currently stands, neither would require a dime of government assistance to get through a repeat of the 2008 financial crisis.

This should come as no surprise to close observers of the GSEs, for it marks nearly a decade of solid financial performance coming off the crisis. And, as we have learned (see [What Happened, Why it Happened, and How to Fix It](#)), the earnings hits they were forced to book during the crisis were largely 'paper losses' forced upon them by their government overseers. But when those losses later had to be reversed, instead of crediting the money back to the companies, the government kept it, spending it on a host of non-housing related purposes instead. (Turns out [the 2008 'bailout' was really a 'stick-up'](#).)

Whether or not you agree with the **Bush Administration's** 2008 decision to seize Fannie and Freddie is immaterial at this point. For as it now stands, the government, through warrants, owns 79.9 percent of their common shares. (The rest are owned by public shareholders – including me and my family.) Thanks to something called the "net worth sweep", however, the government maintains it is entitled to 100 percent of their earnings and equity – in perpetuity! Really? **Uncle Sam** now a mob lender?

What Biden needs to do.

- *Appoint a permanent FHFA director.*

Once past the current controversies which seem to have consumed most of the Administration's bandwidth, the President needs to appoint a permanent head of the **Federal Housing Finance Agency**. There are two current candidates, Acting Director **Sandra Thompson** and **Michael Calhoun**, director of the **Center for Responsible Lending**. Both would be excellent choices.

- *Junk Calabria's Enterprise Capital Rule and propose a new one.*

Upon clearing Senate confirmation, the new director's first order of business should be to throw out the previous administration's enterprise capital rule. You will recall that on his way out the door, former FHFA director **Mark Calabria** imposed an onerous 4-plus-percent capital requirement on Fannie and Freddie. This, even though [virtually every submission](#) FHFA received during the public comment period stated that it should have been closer to 2½ percent. Calabria, a long-standing Libertarian who came into the job with the pre-conceived notion that the GSEs should be required to hold "bank-like capital" (even though they aren't banks and don't take the kinds of risks banks do) ignored them all and did it his way. While not enough capital puts the taxpayer at risk, too much capital impedes the very purposes for which the GSEs were formed: to make available – in good times and bad – the funds necessary for middle- and low-income Americans to buy a home and participate in the American Dream.

- *Formulate a Consent Agreement.*

A Consent Agreement allows the Administration to put whatever restrictions it deems desirable on the GSEs as a condition of their being released from conservatorship. One obvious requirement would be that they meet a certain level of capital by a certain date. With the Enterprise Capital Rule being changed to, say 2½ - 3 percent, they could quickly tap the public markets to meet whatever goal is set.

A Consent Agreement also allows the Administration to achieve its policy goals (i.e., Affordable Housing) and bind the GSEs in a number of other ways. For instance, it could specify that the proceeds of the monetization of the government's warrants should be set aside into a fund dedicated to providing down payment assistance for certain qualified first-time homebuyers. *This would literally open the door to the American Dream to thousands of people in every congressional district.*

A Consent Agreement could also lock in a number of so-called 'reforms' which have already been put into effect. For instance, for years, community banks complained that Fannie and Freddie gave volume discounts to the big banks. That has now changed. Meanwhile, the big banks complained the GSEs were able to use their favorable borrowing rates to acquire mortgages cheaper than they could. That, too, is now out the window. A Consent Agreement would codify these 'reforms' into law.

Finally, a consensus seems to be forming that the GSEs should be regulated like utilities. (Mr. Calhoun and **Lou Ranieri**, among others, recently [published](#) on this.) In return for their *de facto* monopolies, Fannie and Freddie earnings would be capped at a level high enough to promote their statutory goals while at the same time allowing outside shareholders a fair return on their investment. Again, this is something which could easily be accomplished via a Consent Agreement.

- *Declare the government repaid in full.*

There should be no question about this as it is a matter of simple arithmetic (and basic fairness). The government advanced \$193 billion and was paid over \$100 billion more in return. So long as two-plus-two still equals four, the government's sleight-of-hand accounting fails. The retention by the GSEs of **Morgan Stanley** and **JPMorgan** is an indication that there are huge amounts of private capital waiting on the sidelines for this to happen.

No longer a piggy bank.

After, as one judge put it, "siphoning" their profits for a decade, in late 2019, the government finally allowed the GSEs to begin retaining profits to build up what by then was their virtually non-existent capital accounts. True, for every dollar of earnings they retain, the government gets an offsetting credit as a 'liquidation preference'. But it can only collect on this 'preference' if the companies are liquidated. Fat chance. That being the case, the

government no longer has an incentive to allow the present situation to go on. (Especially since it prevents it from realizing the \$100-\$150 billion for its warrants in the meantime.)

The proof is in the stress tests.

As proof that the taxpayer is no longer at risk, one need only look to the last two stress tests. They show that were there to be a repeat of the 2008 financial crisis, neither company would require a dime of government assistance – even at their present low level of capital! And capital raises from the private sector will further insulate the companies from ever needing a future bailout. So, *why are these companies still in conservatorship?*

Those greedy hedge funds.

The only answer I can come up with is that there are people in Washington who don't want to see "speculators" (a/k/a "greedy hedge funds") make money off what they perceive as the government's having come to the companies' rescue back in '08. It's a [false narrative](#), but like any other Big Lie, when it's been repeated for going on 14 years, it's an uphill struggle to convince people otherwise. (It's actually the same silly argument **Alexander Hamilton** swatted away in 1790.)

People who harbor these feelings do not seem to understand that there are literally thousands of Fannie and Freddie shareholders who are neither hedge funds nor greedy – but who have been grievously harmed by a conservatorship now in its 14th year. Those shareholders include, for instance, people like **John Herbin**, president of the **Jamestown State Bank** of Jamestown (pop. 286), Kansas. Mr. Herbin saw 25 percent of his bank's capital wiped out when Fannie and Freddie were seized. (Needless to say, it severely crimped his ability to lend into the community at a time when it was most needed.) Mr. Herbin doesn't want to make a killing; he just wants his bank's capital back (14 years later with no interest).

Likewise, **Nicholas Isbell** of Chevy Chase, Maryland, a Fannie Mae employee who invested his daughter's college tuition fund in Fannie Mae preferred shares (*then rated AA-*). Like Mr. Herbin, he isn't looking for a windfall; he just wants to get his daughter's college tuition fund back (again, 14 years later with no interest).

Then there are the union pension funds, the insurance companies, the mutual funds – and even the **Knights of Columbus** and the **Catholic Order of Foresters**. Should all these shareholders be deemed mere '*collateral damage*' – because some people in Washington don't like the idea of **John Paulson** making money?

True, others did buy for pennies on the dollar when Messrs. Herbin and Isbell were refusing to sell (including, it is reported, Mr. Paulson). But what are they guilty of having done nearly 14 years ago? Betting on a turnaround in the economy. Betting on the rule of law. *Betting on America*.

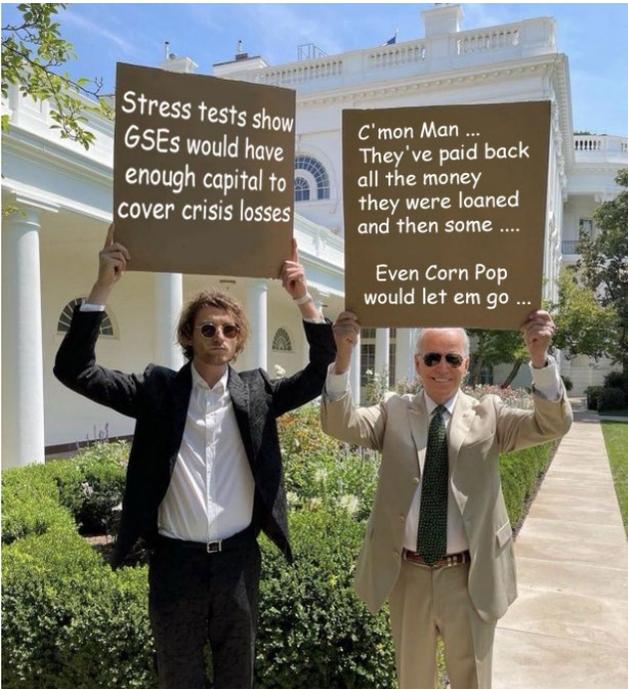
And yes, betting on *the constitution*, which holds that you can't run an interstate highway through the family farm without compensating the owners of said farm. (BTW, if it's any consolation to the naysayers, a number of hedge funds have already gone out of business – or are rumored to have been forced to retrench into family offices – thanks, in part, to the fact that their Fannie and Freddie holdings currently trade at less than 15 cents on the dollar.

Whatever, do the math: if the government releases Fannie and Freddie from their conservatorships and allows them to bring in outside capital, for every dollar the shareholders (who own 20.1 percent of the companies) make, the government (which owns the other 79.9 percent) makes four.

Sounds like a deal to me.

Gary E. Hindes
October 29, 2021
646-467-5242

gary.hindes@delawarebayllc.com



Photographer/photoshopper unknown.

Please note that this report was originally prepared and issued by The Delaware Bay Company, LLC for distribution to its limited partners. Other recipients should seek the advice of their independent financial advisors prior to making any investment decision based upon this report or for any necessary explanation of its contents. The information contained herein is based on sources which we believe to be reliable, but is not necessarily complete and its accuracy cannot be guaranteed. Because the objectives of investors may vary, this report is not to be construed as an offer or the solicitation of an offer to sell or buy the securities herein mentioned. This report is the independent work of The Delaware Bay Company, LLC and is not to be construed as having been issued by, or in any way endorsed or guaranteed by, any other parties, including the issuing companies of the securities mentioned herein. The firm and/or its employees and/or its individual shareholders and/or members of their families and/or its managed funds may have positions in the securities mentioned and, before or after your receipt of this report, may make or recommend purchases and/or sales for their own accounts or for the accounts of other persons from time to time in the open market or otherwise. While we endeavor to update the information contained herein on a reasonable basis, there may be regulatory, compliance or other reasons that prevent us from doing so. The opinions or information expressed herein are believed to be accurate as of the date of this report; no subsequent publication or distribution of this report shall mean or imply that any such opinions or information remains current at any time after the date of this report. All opinions are subject to change without notice and we do not undertake to advise you of such changes. Reproduction or redistribution of this report without the expressed written consent of The Delaware Bay Company, LLC is prohibited.

The Delaware Bay Company, LLC
1370 Avenue of the Americas – 29th floor
New York, NY 10019 USA