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# The Rescue of Fannie Mae and Freddie Mac - Module C: GSE Credit Facility

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## Abstract

In 2007 and 2008, the collapse of the subprime mortgage market and the deterioration of the housing market more generally precipitated a crisis at the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which together held or guaranteed $5.3 trillion in mortgage assets. Over the course of two years, both entities suffered high losses and saw their liquidity positions deteriorate as the market perceived their rapid decline. On September 6, 2008, the Federal Housing Finance Agency (FHFA), pursuant to the authority of the Housing and Economic Recovery Act (HERA) of 2008, took Fannie Mae and Freddie Mac into conservatorship as part of a four-part rescue plan designed to prevent their insolvencies as well as the concomitant collapse of the U.S. mortgage market. This case study discusses the establishment of the secured credit facility, which functioned as a liquidity backstop for both entities. Despite having gone unused, the facility's existence assured the liquidity of the two entities and coincided with a resurgence in demand for their debt.

**Keywords:** GSEs, credit facility, secondary mortgage market, Fannie Mae, Freddie Mac, FHFA, Treasury, liquidity, housing crisis

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[1] The Yale Program on Financial Stability (YPFS) has written 7 case studies that examine in detail the various elements of the government's rescue of the GSEs:

Thompson, Daniel and Rosalind Z. Wiggins. 2018. "The Rescue of Fannie Mae and Freddie Mac, Module A: The Conservatorships."

Thompson, Daniel. 2018. "The Rescue of Fannie Mae and Freddie Mac, Module B: The Senior Preferred Stock Purchase Agreements (SPSPA)."

Vergara, Emily. 2018. "The Rescue of Fannie Mae and Freddie Mac, Module C: GSE Credit Facility."

Zanger-Tishler, Michael and Rosalind Wiggins. 2017. "The Rescue of Fannie Mae and Freddie Mac Module D: Treasury's GSE MBS Purchase Program."

Thompson, Daniel. 2018. "The Rescue of Fannie Mae and Freddie Mac, Module E: The HERA."

Thompson, Daniel. 2018. "The Rescue of Fannie Mae and Freddie Mac, Module F: The Federal Reserve's Large Scale Asset Purchase (LSAP) Program."

Wiggins, Rosalind. 2019, "The Rescue of Fannie Mae and Freddie Mac, Module Z: Overview."

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# GSE Credit Facility

## At a Glance

In 2007 and 2008, the collapse of the subprime mortgage market and the deterioration of the housing market more generally precipitated a crisis at the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), which collectively held or assured $5.3 trillion in mortgage assets. Over the course of two years, both entities suffered high losses and saw their liquidity positions deteriorate as the market perceived their rapid decline. On September 6, 2008, the Federal Housing Finance Agency (FHFA), pursuant to the authority of the Housing and Economic Recovery Act (HERA) of 2008, put Fannie Mae and Freddie Mac into conservatorship as part of a four-part rescue plan designed to prevent their insolvency as well as the concomitant collapse of the U.S. mortgage market.

| Summary of Key Terms | |
|---|---|
| **Purpose:** To equip Fannie Mae and Freddie Mac with a full liquidity backstop should they become unable to fund themselves on the open market | |
| **Announcement Date** | September 06, 2008 |
| **Operational Date** | September 07, 2008 |
| **Expiration Date** | December 31, 2009 |
| **Legal Authority** | Housing and Economic Recovery Act of July 2008, Section 117 |
| **Interest Rate** | LIBOR + 50bps |
| **Eligible Collateral** | Mortgage-backed securities issued by Fannie Mae and Freddie Mac and FHLB advances |
| **Government Sponsor** | U.S. Treasury |
| **Participants** | None |
| **Total Credit Extended** | $0 |

The secured credit facility was created to serve as a funding backstop for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. The facility acted as a channel through which Treasury could make unlimited collateralized short-term loans – as needed – to both entities through December 31, 2009. Treasury funding was harnessed from its accounts at the Federal Reserve Bank of New York (FRBNY), which served in a custodial role during the program's existence. Eligible collateral included mortgage-backed securities issued by the two entities as well as advances made by the Federal Home Loan Banks (FHLBs). Loans were designed to be short-term, with maturities ranging from seven to 30 days. Treasury charged interest rates equivalent to the London Interbank Offered Rate (Libor) of comparable duration plus a premium of 50 basis points.

The Credit Facility expired on December 31, 2009, having gone unused. During the Credit Facility's lifetime, Fannie Mae and Freddie Mac satisfied their funding requirements using other means, including debt issues on the open market and draws from Treasury pursuant to the senior preferred stock purchase agreements (SPSPAs).

## Summary Evaluation

Because it went unused, the Credit Facility has not received as much attention from scholars as have the more prominent features of the government's four-part intervention with respect to Fannie Mae and Freddie Mac. Nonetheless, the Credit Facility's mere presence assured the liquidity of the two entities at a time of extreme market fragility and coincided with a later resurgence in demand for their debt.

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# I. Overview

## Background

The Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) are two government-sponsored enterprises (GSEs) that were created to support the secondary mortgage market and also to fulfill certain affordable housing goals. They do this by purchasing whole loans from mortgage lenders and compiling them into mortgage-backed securities (MBS), which they then guarantee and sell to investors. The GSEs also retain some of the loans they purchase as portfolio investments. The GSEs raise funds by issuing debt which, prior to 2008, had been perceived by markets to be a very safe investment; as a result, GSE debt at the time was held by financial institutions and government entities around the world (FCIC 2011).

By the middle of 2007, issues confined to subprime mortgages had spilled over into the wider U.S. mortgage market, causing an overall contraction in private securitization and an increase in the share of new mortgages purchased by Fannie Mae and Freddie Mac (FCIC 2011). Not long after, the GSEs started to run into serious problems of their own. Starting in late 2007, the two entities began to post huge quarterly losses, with each amassing several billions in losses by the middle of 2008. Moreover, as the market began to perceive the steep decline of the GSEs, investors started to pull back from their debt and capital offerings, while concerns about their solvency abounded. Compounding these worries was the inordinately high leverage of the GSEs. At the end of 2007, the GSEs were leveraged 75-to-1, holding or assuring $5.3 trillion of mortgage assets on a collective capital base of only $70.7 billion (FCIC 2011).

On September 6, 2008, pursuant to the authority of the Housing and Economic Recovery Act (HERA) of 2008, the Federal Housing Finance Agency (FHFA), in cooperation with the U.S. Treasury and the Federal Reserve, put the GSEs into conservatorship as part of a four-part rescue plan designed to prevent their likely insolvency and the concomitant collapse of the U.S. mortgage market. Other components of the plan were: 1) to enter into senior preferred stock purchase agreements (SPSPAs) with each GSE, 2) to establish a secured credit facility for each GSE, and 3) and to purchase their mortgage-backed securities (Treasury PR 09/07/2008). This case study focuses on the establishment of the GSE credit facility.

## Program Description

The GSE credit facility ("the Credit Facility") was established to provide secured loans – as needed – to Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks (FHLBs), other government-sponsored enterprises that operated in the U.S. mortgage market. Our primary focus herein is to examine the facility with respect to Fannie Mae and Freddie Mac. Much of the discussion that follows, however, also applies to the FHLBs. Like the GSEs, no FHLB utilized the facility before it expired on December 31, 2009.

Under the Credit Facility, Treasury could extend unlimited funding[3] to the GSEs although – in keeping with requirements set out by HERA – no loan it issued could mature later than December 31, 2009. By design, the Credit Facility was unlimited, in effect allowing it to serve as a full liquidity backstop for the GSEs.

The Credit Facility offered only short-term loans, usually with maturities ranging from seven to 30 days. In the interest of the taxpayer, all loans were required to be secured by satisfactory collateral. By Treasury's definition, satisfactory collateral included only mortgage-backed securities issued by Fannie Mae and Freddie Mac as well as FHLB advances. Treasury also was responsible for determining the proper haircut to apply to collateral offered by the GSEs.

The Credit Facility charged an interest rate equivalent to the London Interbank Offered Rate (LIBOR) plus a premium of 50 basis points. Given that the market effectively treated the GSEs as if they were government agencies, and usually gave them very favorable rates, this was perceived to be a penalty rate. The Treasury Secretary could alter the interest rate charged by the Credit Facility as he or she saw fit (Ibid).

Treasury funded the Credit Facility using its account at the Federal Reserve Bank of New York (FRBNY), which served in a custodial role during the program's existence (Fact Sheet 09/07/2008). All loan requests were subject to the approval of the Treasury Secretary, who also held the power to set the terms on individual loans (Ibid).

Other conditions pertaining to the length and amount of each loan were as follows:

- "The term of a loan may not be extended, but a maturing loan could be replaced with a new loan under the same borrowing procedures as the initial loan."
- "Loans could be pre-paid with two days' notice, and loans could be called before their scheduled maturity date."
- "Loan amounts would be based on available collateral" (Ibid).

**Outcomes**

The Credit Facility expired on December 31, 2009, having gone unused by both Fannie Mae and Freddie Mac. As it turned out, both entities were able to satisfy their liquidity requirements elsewhere on more favorable terms (Fannie 10-K 2009, Freddie Mac 10-K 2009).

Even as the Credit Facility went unused, the Treasury remained a primary source of funding for the GSEs. From September 2008 through December 2009, the two entities collectively drew more than $110 billion from Treasury under the SPSPAs. At the end of 2009, Treasury effectively uncapped Treasury's commitment via the SPSPA, allowing the government to

[3] Funding was subject only to the federal debt ceiling, which was raised by $800 billion with the enactment of HERA.

provide unlimited funding to the GSEs from 2010-2012, after which time the funding limit reverted to $200 billion per GSE plus any amounts it had drawn during that period. This arrangement – made possible by the second amendment to the SPSPA – was critical to maintaining confidence in the GSEs, as both the Credit Facility and the MBS purchase program were set to expire on December 31st.

# II. Key Design Decisions

1. **The Credit Facility derived legal authority from the Housing and Economic Recovery Act of 2008.**

As the housing correction worsened and the outlook for Fannie Mae and Freddie Mac deteriorated, government officials ramped up efforts to pass legislation to create a new, more powerful GSE regulator with the authority to properly mitigate concerns at the entities and to rescue them, if necessary. Government officials worried that the Office of Federal Housing Enterprise Oversight [OFHEO], then the safety and soundness regulator of the GSEs, had insufficient authority over the two entities and possessed no viable mechanism to rescue the GSEs should they verge on disorderly collapse (Thompson 2017 E).

On July 30, 2008, in response to pleas from federal financial officials, the U.S. government adopted the Housing and Economic Recovery Act (HERA). In addition to creating a new, more powerful GSE regulator (FHFA) with the authority to impose higher capital standards and to sanction unsafe behavior, HERA also significantly increased the government's capacity to respond to a crisis. More specifically, HERA granted the Treasury the power to act as a financial backstop for the GSEs, subject only to its determination that such an action was necessary to preserve the stability of the mortgage market and the financial system more generally (HERA).

After making such a determination, Treasury could purchase an unlimited amount of the GSEs' capital securities or debt, so long as such purchases took place before December 31, 2009, when Treasury's authority to purchase these instruments was set to expire. In September 2008, the Treasury established the Credit Facility, entered into the SPSPA, and launched the GSE MBS purchase program pursuant to the new funding authority granted by HERA.

2. **The Credit Facility constituted one part of a four-part rescue plan for Fannie Mae and Freddie Mac.**

On September 7, 2008, the Treasury and FHFA announced a four-part rescue plan designed to prevent the insolvencies of Fannie Mae and Freddie Mac as well as the parallel collapse of the mortgage market, consisting of 1.) placing the two GSEs into conservatorships, 2.) entering into the SPSPA, 3.) establishing the Credit Facility for each entity, and 4.) launching the Treasury GSE MBS purchase program.

The rescue plan was designed such that each component addressed a particular set of constraints confronting Fannie Mae and Freddie Mac. The role of the Credit Facility was to provide a liquidity backstop for the GSEs, ensuring their access to stable funding should demand for their debt securities take time to recover.

3. **Each GSE could borrow an unlimited amount through the Credit Facility.**

Unlike their standing lines of credit from Treasury – which afforded each GSE a maximum of $2.25 billion – the Credit Facility offered the GSEs the opportunity to borrow an unlimited amount from Treasury, although – in keeping with requirements set by HERA – this funding could extend past December 31, 2009. By design, the Credit Facility was unlimited, in effect serving as a full liquidity backstop for the GSEs during its lifetime. Although the government never explicitly stated how much it realistically would have committed to the GSEs, the HERA raised the federal debt limit by $800 billion to accommodate the potential rescue of them.

4. **Treasury charged each GSE a penalty rate on all loans.**

The initial interest rate was set at Libor of a comparable duration plus a premium of 50 basis points (Libor + 50bps). Given that the market effectively treated the GSEs as if they were government agencies, and usually gave them very favorable rates, this was perceived to be a penalty rate. As a result, the GSEs were incentivized to obtain funding elsewhere, if available, consistent with the facility's purpose as a backstop, or a lender of last resort. As it turned out, the GSEs were able to satisfy their funding requirements elsewhere on more favorable terms, and thus never utilized the Credit Facility.

5. **The Credit Facility was designed to offer only short-term loans.**

Under the credit facility, loans could be extended for terms ranging from seven to 30 days. The creation of a short-term lending facility reflected Treasury's attempt to address the short-term funding constraints experienced by the GSEs, specifically in the repo market. In addition, the Credit Facility complimented rather than overlapped with funding available to the GSEs pursuant to the SPSPAs. At the same time, shorter loan terms also functioned to better protect the taxpayer should the firms ultimately not stabilize.

6. **Satisfactory collateral was defined as agency mortgage-backed securities issued by Fannie Mae and Freddie Mac as well as FHLB advances.**

All loans extended through the facility were required to be secured by satisfactory collateral, which Treasury defined only as agency mortgage-backed securities and FHLB advances. As of June 30, 2008, the GSEs collectively held over $600 billion of their own securities, thus making the Credit Facility a viable source of substantial funding, if needed[4] (Fannie Mae 10-Q, Freddie Mac 10-Q). Treasury also took on the responsibility of evaluating collateral submitted by each GSE and applying proper haircuts, helping to protect taxpayers from the risk of lending to potentially unstable firms.

[4] This figure only accounts for securities of their own held by Fannie Mae and Freddie Mac, and not each other's.

# III. Evaluation

It is difficult to evaluate the isolated impact of the Credit Facility as it was just one part of a multifaceted rescue plan for the GSEs. Overall, the rescue effort was designed to prevent the destabilizing insolvency of the GSEs and to restore their ability to fund themselves in the open market. From November 2008 to March 2012, the GSEs collectively received $187.5 billion in funding from the federal government, all of which they received via the SPSPAs.

The Credit Facility expired on December 31, 2009, having gone unused. During fiscal year 2009, demand revived for Fannie Mae and Freddie Mac debt securities, especially compared with demand during the previous year. During fiscal year 2009, Fannie Mae issued nearly $1.7 trillion in gross short- and long-term debt securities, while Freddie Mac issued nearly $1 trillion (Fannie 10-K 2009, Freddie Mac 10-K 2009). The firms have credited the government rescue – not only of themselves, but also of the broader market – with helping to restore confidence in them as well as within markets for their debt securities (Ibid).

# IV. References

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# V. Key Program Documents

- Fact Sheet: Government Sponsored Enterprise Credit Facility (09/7/2008) – *document that describes the framework of the credit facility.* https://www.treasury.gov/press-center/press-releases/Documents/gsecf_factsheet_090708.pdf
- Budget Performance of the Housing Government Sponsored Enterprise Programs– *Treasury document describing the credit facility and stating that it was not used.* https://www.treasury.gov/about/budget-performance/budget-in-brief/Documents/CJ-GSE.pdf

**Legal/Regulatory Guidance**

- Housing and Economic Recovery Act of 2008 SEC. 1117- *the law authorizing the FHFA to place the GSEs in conservatorship in 2008.* https://www.fhfa.gov/Government/Documents/GPO

**Press Releases/Announcements**

- Paulson Announces GSE Initiatives (07/31/2008) – *Treasury Secretary Henry M. Paulson, Jr. communicating the steps created to assist Fannie Mae and Freddie Mac.* https://www.treasury.gov/press-center/press-releases/Pages/hp1079.aspx
- The Conservatorship of Fannie Mae and Freddie Mac (09/25/2008) – *statement from James B. Lockhart III, Director of the FHFA, on the 2008 conservatorship.* https://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-James-B-Lockhart-III-Director-FHFA-Before-the-US-House-Committee-on-Financial-Services.aspx

**Media Stories**

- Paulson's Announcement on Fannie, Freddie (09/07/2008) – *Treasury Secretary Henry M. Paulson, Jr. announces the necessary actions to assist the GSEs.*

https://thetruthaboutfannieandfreddie.wordpress.com/2015/05/10/paulsons-announcement-on-fannie-freddie-september-7-2008/

- U.S. Unveils Takeover of Fannie and Freddie (09/07/2008) - *states that the credit facility was implemented to act as a last resort of funding.* https://dealbook.nytimes.com/2008/09/07/us-unveils-takeover-of-fannie-and-freddie

## Reports

- The Financial Crisis Inquiry Report: Conclusions of the Financial Crisis Inquiry Commissions – *report of the government's premier commission studying the crisis. Chapter 17, specifically discusses the rescue.* https://www.gpo.gov/fdsys/pkg/GPO-FCIC/pdf/GPO-FCIC.pdf?utm_source=rss&utm_medium=rss