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Fannie Mae & Freddie Mac IPO Headlines

Implications for the Mortgage- Backed Securities Market



MEEDER
PUBLIC FUNDS

Recent media reports have rekindled 2025's favorite debate—what do we do with Fannie and Freddie?

We believe the question of whether or not to take Fannie Mae or Freddie Mac public is of much more relevance for equity investors than fixed income investors—we don't believe that decisions involving the capital structure of the company (i.e. whether or not the U.S. Treasury keeps its block of senior preferred stock and warrants to purchase nearly 80% of the company's common equity) will fundamentally change these companies' operations.

Neither do we believe that, given the importance of Fannie and Freddie to the U.S. housing market, the government can say or do anything to change investors' view of the implicit guarantee of the government in housing markets, which we've already seen become explicit once before. But the good news is that this continued involvement, no matter what decision is made on Fannie and Freddie privatization, means that mortgage rates probably remain artificially low, benefiting U.S. homeowners—we don't believe the predictions that 30-year mortgage rates will become more volatile and up to 50bp higher.

A choice to convert the Treasury's preferred stake to common equity, which would then dilute existing equity holders, would be equity-negative, while writing down the Treasury's stake totally would be equity-positive, and the changing odds of that happening to a small part of the capital stack are why you see such wild swings in the prices of these two equities (FNMA and FMCC), but we see limited impact from the narrow perspective of investors in debt securities tied to Fannie Mae and Freddie Mac, or those companies' operations.

ANALYSIS

The Wall Street Journal recently reported that the U.S. government may consider taking Fannie Mae and Freddie Mac public via an IPO as early as November. Early discussions suggest a \$30 billion capital raise, which would value the combined entities at over \$500 billion—making it the largest IPO in history. This valuation is similar to the rumored amount over the last few months, and we note that Fannie and Freddie together made over \$32B in 2024, implying an IPO price-to-earnings ratio of only ~16x, well below the S&P 500's current ~25x and suggesting that the ultimate proceeds could be much higher.

Proponents of privatization argue that greater competition in the market would benefit homeowners, with the added benefit of shifting the risk of failure from taxpayers to the private market, with skeptics doubting that greater competition would outweigh increased costs from reducing the government's implicit guarantee, and noting that Fannie and Freddie are so intertwined with the government's own interests (helping individuals pursue "the American dream") that there's no way the government would let these firms fail, regardless of what they say.

The administration has met with major investment banks to explore the concept, though no formal plan has been released, and the major sticking point of any plan will be driven by government, namely what is to be done with the Treasury's huge senior preferred stock holdings at both of these GSEs. Remember that in exchange for providing endless liquidity to backstop "guaranteed" mortgages that proved riskier than Fannie or Freddie thought, the Treasury took a \$200B senior preferred stock position in 2009. Though this preferred stock has been amended a few times to allow the GSEs to retain their earnings on their balance sheet and hopefully one day exit conservatorship, the preferred stock didn't go anywhere, and so Fannie and Freddie technically have negative book value including the government's holdings.

During the first decade of conservatorship, Fannie and Freddie between them returned over \$300B to the Treasury—so the argument could be made that the government has got their money back, and the preferred stock could simply be written off, which is probably the direction this proposal would need to ultimately head in. However, the process would be highly complex, involving resolution of long-standing litigation, regulatory hurdles, and possible structural changes if the entities were merged.

GUARANTEE STATUS

- » **Current:** Fannie Mae and Freddie Mac carry an implied U.S. government guarantee, historically factored into their credit ratings.
- » **Potential Change:** There has been indications that the guarantee would be maintained if the IPO proceeds, though no details have been released regarding whether it would become explicit.
- » **Market Response:** No change in agency MBS spreads following the news suggests the market sees minimal near-term impact on the guarantee or creditworthiness of the securities.
- » **Meeder View:** We're not so sure that taking Fannie and Freddie public, and presumably resolving the question of the Treasury's stake, would actually result in lower "government involvement"—several GSEs like Federal Home Loan Banks don't directly have government stakes, but still benefit from the indirect guarantee of the U.S. government. The true source of the implicit guarantee is the importance of Fannie and Freddie to the U.S.

MARKET REACTION & DATA POINTS

- » **Agency MBS option-adjusted spreads** have remained unchanged from late July through the announcement.
- » **Unsecured agency bond spreads** have also been stable, indicating muted investor concern.
- » **The lack of spread movement** reflects market confidence in continued government support for MBS.
- » **Meeder View:** Concerns are that reduced government involvement would lead to higher and more volatile mortgage rates, as reduced government involvement would require higher interest rates to compensate for increased risk. But as we've laid out, reduced government involvement in Fannie and Freddie's capitalization structure does not equal reduced government involvement in mortgage markets. Further, most economic analyses we've viewed do not point to Fannie and Freddie's public structure as leading to higher rates when they were public (pre-2008) vs. when they were private (post-2008).

KEY TAKEAWAYS FOR INVESTORS

No Immediate Impact

Current valuations and spreads remain steady, signaling that investors do not anticipate significant structural changes in the short term.

Focus on Fundamentals

Portfolio positioning in agency MBS should remain guided by yield, duration, and credit fundamentals rather than headline risk.

Monitor Developments

If an IPO proceeds, potential changes in governance, capital structure, or guarantee terms could have longer-term implications for the sector.

Meeder View

The question of public or private is most relevant for common equity holders, rather than for fixed income investors—even if the Treasury does not have a stake in Fannie and Freddie, their business model still involves guaranteeing the MBS that most investors are focused on, and their debt still probably benefits from an implicit guarantee even if the administration tries to claim none exists anymore.

Our View

At present, the IPO discussions are more headline than market-moving event, and we view these discussions as having more of an effect on the equity prices of FNMA and FMCC than that of their debt securities or operations. We remain constructive on agency securities, with a focus on disciplined portfolio construction and ongoing monitoring of policy developments.



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