PENNYMAC POLICY PULSE

DECEMBER 2025

HOUSING AFFORDABILITY POLICY PLAYBOOK

The United States faces a structural and acute housing affordability crisis that demands an “all hands on deck” approach across all levels of government and the private sector. Housing costs have risen sharply relative to household incomes, leading to diminished economic mobility and increased housing instability. This crisis impacts not just low-income families, but is increasingly pricing out middle-class households and potential first-time buyers. Addressing this monumental challenge requires recognizing that while there is no single panacea to solve the nation’s housing woes, a coordinated effort leveraging numerous policy levers can meaningfully reduce costs, increase supply, and expand access to affordable homeownership.

The following report details some of the policy proposals we have discussed when engaging with policymakers and other stakeholders. This list is not comprehensive, and it purposely avoids some of the more structural questions — GSE reform, immigration, demographic dynamics — to focus on acute policy proposals. Given Pennymac’s area of expertise, this document focuses exclusively on residential policy issues.

HOUSING AFFORDABILITY PROPOSALS

HELPFUL

- Optimize the GSE Refinance Channel
- Reform the Capital Gains Exclusion for Primary Residences
- Support Manufactured Housing and Modular Construction
- Overhaul Inefficient Local Zoning and Land-Use Regulations
- Mobilize Federal Capital and Financing Innovation
- Embrace the Technical Tweaks That Can Help At the Margin

UNHELPFUL

- Portable Mortgages Are Not Viable
- Lower LLPAs on Second Homes and Investor Properties Will Not Help Affordability
- Juicing Demand Via Standalone Pricing Cuts Rather Than Holistic Pricing Reviews
- 50-Year Mortgage Concerns Outweigh Any Benefit
- Acceptance of the Status Quo

HELPFUL PROPOSALS

Optimizing the GSE Refinance Channel: An Enhanced Path to Affordability

The current high-interest-rate environment has created significant market gridlock, freezing millions of homeowners in place and severely limiting the affordability of new loan products for many others. While FHA and VA loans possess statutory assumability features and streamlined refinance options, the GSEs must instead leverage their mandate and technological capabilities to create a conventional equivalent optimized for low-friction, cost-saving refinances.

The CFPB could amend the Qualified Mortgage (QM) Rule to provide the GSEs with the latitude for a streamlined refi program, but even without CFPB action there is a path to reduce refi barriers without increasing undue risk. The core of an optimized GSE refi program lies in strategically deploying existing technological and risk management tools, continued innovation via pilots, and a review of pricing.

On the tech front, the GSEs should be applauded for their work on appraisal waivers and enhanced offerings like Value Acceptance + Property Data Collection, which provides an affordable alternative to traditional appraisals. On the pilot front, we support an extension of the GSE title pilots beyond the May 2026 sunset. These pilots, which are focused exclusively on refis, provide valuable insight that should build toward innovation and reduced costs. Finally, on the pricing front, we believe there is a strong policy case for the FHFA to either reduce or remove LLPAs on certain rate-term refis given the GSE focus on mission and their risk on these loans.

Reforming the Capital Gains Exclusion for Primary Residences

The federal tax code inadvertently creates significant constraints on housing supply and mobility by disincentivizing long-term homeowners from selling their primary residences. The current capital gains exclusion—$250,000 for single filers and $500,000 for married couples—was established in 1997. Since then, housing appreciation has far outpaced inflation and the static caps. This differential treatment leads to a capital gains lock-in effect. This effect is particularly acute among empty-nest seniors, many of whom own homes ~3 times larger than they need. They avoid selling to evade capital gains taxes on accumulated appreciation, and because there will be a stepped-up basis if the asset is passed on after they pass on. This results in a structural misallocation of housing, where large homes are not brought onto the market, constraining growing families who are often stuck in inadequate spaces, thus suppressing housing turnover. If the caps were merely indexed to house price growth since 1997, they would now be $885,000 and $1,775,000, respectively.

Modifications to the capital gains treatment could significantly influence housing market dynamics and mobility. While various reform approaches, from indexing to total elimination, would reduce federal tax revenue by $6B to $10B annually on a static basis, this cost is generally far less than other housing tax policies and could be substantially offset by positive behavioral responses. Unlocking housing stock would lead to increased sales, generating substantial state and federal income and sales tax collection from additional economic activity like remodeling and furniture purchases.

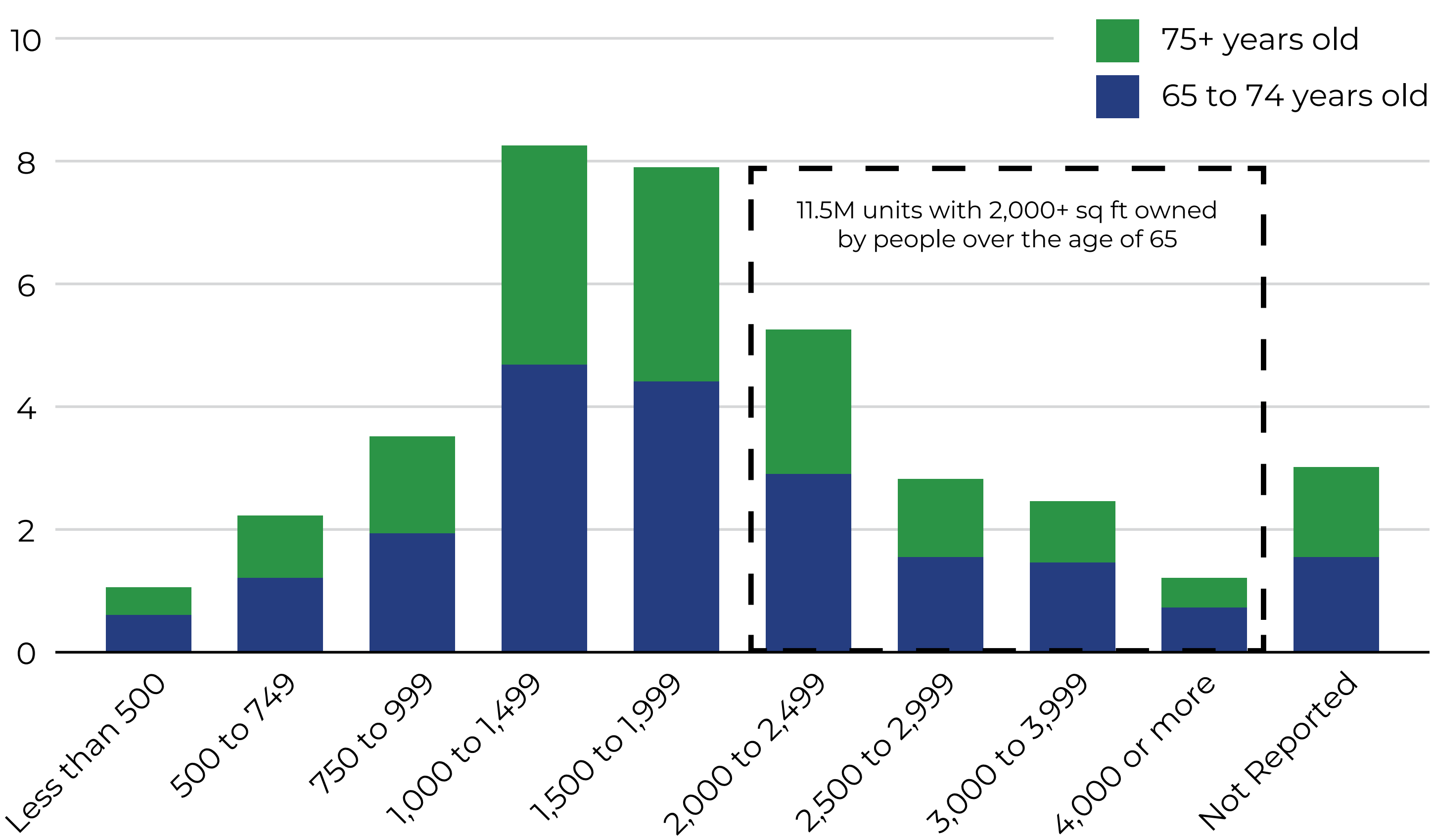
From a sizing perspective, the National Association of Realtors found that 34% of the market, or 29 million homeowners, could already exceed the $250k capital gains exclusion for single filers. They also find that by 2030, 56% of homeowners are projected to potentially exceed the \$250k threshold, and ~23% could surpass the \$500k threshold. From an addressable market perspective, there are roughly 11.5 million homeowners over the age of 65 living in homes with >2,000 square feet.

Reasonable minds can differ on the precise policy prescription for this issue, but we believe any serious discussion on housing affordability should include this topic. Policymakers should consider lifting these caps, providing a one-time holiday, or innovative solutions such as allowing the proceeds to be put in tax-advantaged retirement accounts.

Manufactured Housing and Modular Construction

The chronic U.S. housing shortage necessitates innovative solutions that circumvent the high costs and low productivity inherent in traditional site-built construction. Factory-built housing, comprising both manufactured and modular homes, is uniquely positioned to address this crisis, given that manufactured housing costs ~50% less to build per square foot than traditional site-built housing. Despite this clear cost advantage, industrialized housing methods have struggled to achieve scale; for instance, modular homes currently constitute only about 3% of single-family production. Realizing this potential requires an industrial strategy to overcome the structural impediments that restrict production, eliminate costly regulatory complexity, and secure reliable financing.

OF HOUSING SUPPLY UNITS BY SQUARE FOOTAGE AND SIZE OF HOUSEHOLD (M)



Source: AHS, Moody's Analytics, Pennymac

The primary barriers to scaling factory-built housing stem from local regulatory friction and fragmented financial access. Manufactured housing, even when built to the federal HUD Code, continues to face significant local zoning and land-use barriers that limit where these affordable homes can be sited. Furthermore, the majority of manufactured homes are titled as personal property, forcing buyers to utilize high-interest chattel loans instead of traditional mortgages, which stifles demand and limits supply. This lack of competitive financing, particularly the absence of a robust secondary market for these personal property loans, restricts loan supply for qualified borrowers and prevents the industry from growing to meet the affordability challenge.

Federal policymakers should enact targeted legislative and administrative reforms to unlock this channel. Congress should eliminate the requirement for a permanent steel “chassis” base in HUD-code manufactured homes, a change estimated to reduce costs by $5,000 to $10,000 per home. Simultaneously, Congress must authorize and fund HUD to develop an efficient, national, performance-based building code for modular housing to preempt fragmented state and local rules, allowing this product to scale nationwide. On the financing side, the FHFA could require the GSEs to begin purchasing personal property loans for manufactured housing (something they are explicitly authorized to do in their charters), which would create a robust secondary market, increase access to lower-cost credit, provide enhanced consumer protections (mortgage servicing alone would be hugely impactful), and substantially increase the overall supply of affordable units.

Overhauling Inefficient Local Zoning and Land-Use Regulations

Restrictive land-use policies are a long-standing, fundamental hurdle preventing increased housing supply, increasing construction time, and driving up costs. Locally determined rules—including minimum lot size requirements, minimum parking requirements, height restrictions, and the imposition of single-family zoning on 70% of residential land—significantly restrict development density and unit count. The high costs of these restrictions reach across neighborhoods, affecting labor mobility and aggregate output.

The key solutions involve shifting away from discretionary, complex processes toward clear, scale-driven, and “by-right” zoning rules. Examples of high-impact reforms include eliminating minimum parking requirements, which can reduce the number of apartment units by 13% in cities like Los Angeles and add significant construction costs. Policies to increase density, such as reducing minimum lot sizes or legalizing Accessory Dwelling Units (ADUs), are gaining momentum at the state and local levels (California, Oregon, etc). We continue to believe the federal government can spur these state and local reforms by tying federal transportation, education, and infrastructure funding to local zoning reform objectives. Additionally, the federal government has convening power to advance these priorities with state and local officials.

The mechanisms within local zoning codes that allow for small groups of individual homeowners to block development of light touch density do nothing but exacerbate the housing supply issues that we face. In fact, these zoning codes and local influence campaigns are often used to block luxury development in many localities. Take the case of Atherton, CA: median household income of $250,000, median home price

$8.2 million. The development of 16 luxury townhouses was blocked by the city council in 2023 (following a private lobbying campaign by, among others, Steph Curry) due to “privacy concerns.” These townhouses would have been around $2.5 million each based on current prices in the city. It is hard to imagine these privacy concerns could not have been resolved.

Mobilizing Federal Capital and Financing Innovation

The federal government must mobilize capital sufficient in scale to meet the affordability crisis. This can be done in myriad ways, but we highlight a few below:

- **LIHTC Reform:** The Low-Income Housing Tax Credit (LIHTC) remains the largest federal construction subsidy. To meet the moment, Congress should expand the 9% LIHTC tax credit allocation by 50% nationally (yielding 200,000 more affordable homes over 10 years) and exempt affordable housing projects from the state Private Activity Bond (PAB) cap.
- **Public Housing & Preservation:** Preserving existing deeply subsidized housing is critically important. There is an estimated $70 billion backlog of capital repairs in public housing. Congress should authorize a one-time appropriation to rehabilitate and update the public housing and HUD-assisted stock.
- **Homesteading 2.0:** The Federal government owns vast lands (especially west of the Mississippi), much of it surrounding growing metropolitan areas. As has been proposed by the American Enterprise Institute, auctioning off only 0.3% of federal land would open up 267,000 acres of land capable of holding 3 million newly constructed housing units. Some of the land would be capable of supporting entire new cities, fostering new economic centers for the country.
- **The Neighborhood Homes Investment Act:** The Neighborhood Homes Investment Act (NHIA) is designed to increase housing supply by establishing the Neighborhood Homes Credit (NHC), a federal tax credit aimed at promoting the new construction or substantial rehabilitation of affordable, owner-occupied homes in distressed urban, suburban, and rural neighborhoods. The primary mechanism for boosting supply involves using these credits to bridge the financial gap between the total cost of developing or renovating a property and the lower price required to make it affordable to eligible homebuyers. This incentive attracts private investor capital, as investors are allocated the tax credit once the home is sold to a qualified buyer, thereby making previously infeasible construction projects financially viable.

Embrace Technical Tweaks

So much time in Washington is spent on the macro, but there is value in embracing an “all the above” strategy that makes targeted or technical changes that could help, even at the margin.

- **Let the GSEs Restart Front-End Lender Riskshare:** Front-end lender riskshare is a sensible policy solution structured specifically to align incentives between the GSEs, the Seller/Servicer, and MBS investors by ensuring the originating lender retains the first loss credit risk on the loans sold. More broadly, integrating Credit Risk Transfer (CRT) directly into the GSE business model substantially improves Enterprise profitability, helps accelerate the required capital build, and eases the upward pressure on G-Fees.
- **Ginnie Mae Liquidity:** Enhanced Ginnie Mae liquidity directly benefits borrowers by increasing the access and affordability of FHA, VA, and USDA loans. Measures like standalone advance financing and excess servicing

securitization reduce financial strain on issuers (lenders/servicers), especially during market stress. This improved stability and capital management for mortgage servicers translates into lower execution costs. Ultimately, by mitigating issuer risk and increasing the overall efficiency of the secondary market, this liquidity enhancement is passed through to the borrower in the form of lower interest rates and greater credit availability.

- **Assumable Mortgages:** Assumable mortgages at FHA, VA, and USDA allow buyers to inherit the seller's low rate, mitigating the lock-in effect, which explains about half of the recent decline in mobility. This policy should be administratively promoted to alleviate constraints on housing supply and household mobility. Regulatory actions, such as raising the fee cap for servicers, are needed to fairly compensate their participation in the assumption process. We also recognize that a second lien is often necessary, so policymakers should consider supporting policies that would increase availability of that product.
- **GSE Retained Portfolio:** Increased GSE purchases of MBS boost demand in the secondary market, which subsequently narrows the spread between the mortgage rate and the Treasury yield. This crucial spread compression directly translates into a lower cost of funds for lenders, allowing them to offer more affordable interest rates to consumers. However, this powerful tool should only be used with strict guardrails to prevent a return to the excessive risk-taking seen prior to 2008. Under the existing Preferred Stock Purchase Agreements (PSPAs), each GSE has $225B in portfolio capacity.
- **Increased Latitude for Fixed-to-ARM in VA/FHA:** The current Net Tangible Benefit test for a fixed-to-ARM streamline refinance at both FHA and VA requires a steep 200bps reduction in interest rate. Policymakers should consider lowering this threshold as it could provide meaningful savings for eligible borrowers without eroding essential consumer protections.

UNHELPFUL PROPOSALS

While innovative solutions are required, policy must be disciplined and targeted, avoiding misguided proposals that distort market signals or misallocate scarce resources.

Portable Mortgages Are Not the Answer

The widespread implementation of "portable mortgages" for conventional loans is a brute-force attempt to 'solve' the lock-in effect that introduces significant unintended consequences and threatens the structural integrity of the conventional mortgage market. The U.S. mortgage system is fundamentally built on securitization, where loans are priced based on the specific property backing them. Allowing a loan to be transferred to a new, different property fundamentally breaks the models used to assess collateral risk and loan duration.

Investors would demand higher compensation for this increased and unpredictable risk, which would push structural mortgage rates higher for all new borrowers and renters. Furthermore, the benefits of portability would be highly selective, only favoring current low-rate mortgage holders, while dramatically increasing complexity in loan servicing (lien, escrow, taxes, title obligations all depend on the property). The policy focus should remain on optimizing the existing, risk-managed assumable FHA/VA loan programs.

Lowering LLPAs on Second Homes and Investor Properties Will Not Help

Lowering Loan-Level Price Adjustments (LLPAs) on second homes and investor properties is a flawed policy proposal because it directly contravenes the GSEs' fundamental mission of supporting affordable owner-occupied housing. These properties are already served by a robust and deeply liquid private capital market that does not require a taxpayer backstop. By offering cheaper financing through the GSEs, regulators would merely be supplanting private banks and investors, thereby distorting capital allocation and creating moral hazard. This action directs limited government-supported resources away from the families most in need—first-time and moderate-income primary residents—to subsidize discretionary or speculative real estate activity.

Furthermore, this policy would actively undermine national affordability efforts by increasing competition for housing inventory. By reducing the cost of credit for investor buyers, the GSEs would effectively incentivize and subsidize the institutional acquisition of single-family homes, particularly the "starter" and mid-priced properties sought by first-time home buyers. This makes it harder and more expensive for families to achieve homeownership, contributing to a permanent renting class. The result is a perverse outcome where the regulation intended to solve an affordability crisis ends up driving up prices for the very homes that are crucial to building middle-class wealth.

Finally, reducing these LLPAs is fiscally irresponsible, as it causes the GSEs to take on greater uncompensated credit risk. Investment and second homes are historically riskier loan categories with higher default rates during economic downturns. LLPAs exist precisely to ensure that this higher risk is adequately capitalized. By artificially depressing these fees, the FHFA shifts the ultimate burden of risk onto the American taxpayer, who continues to back the GSEs through the PSPA backstops. This violates the core principles of safety and soundness and diverts capital that should be reserved to ensure stability for the essential, mission-driven primary housing market.

Juicing Demand Via Standalone Pricing Cuts Is a Sugar High, Not a Solution

As a conceptual matter, we caution against efforts aimed at improving housing affordability through broad-based pricing cuts. All else being equal, affordability-driven price cuts ramp demand, which drives prices higher, and ultimately hurt the individuals policymakers are trying to help.

Instead, pricing decisions should be made through a multilayered consideration of expected losses, return requirements, and subsidy delivery.

We believe the GSE pricing framework warrants review. The LLPA grid for purchase loans, in particular, is ripe for a shift towards more appropriately pricing risk. We also see a strong case for reviewing FHA mortgage insurance premiums, especially if the fund appears as actuarially sound as it has when we see the annual report later this month. With all that being said, our foundational belief is that pricing decisions should be driven by a thoughtful policy process rather than political short-termism.

Acceptance of the Status Quo Is a Structural Impediment to Progress

Resolution of the nation's affordability challenge is meaningfully hampered by the gradual normalization of the status quo, especially with respect to contentious public policy questions.

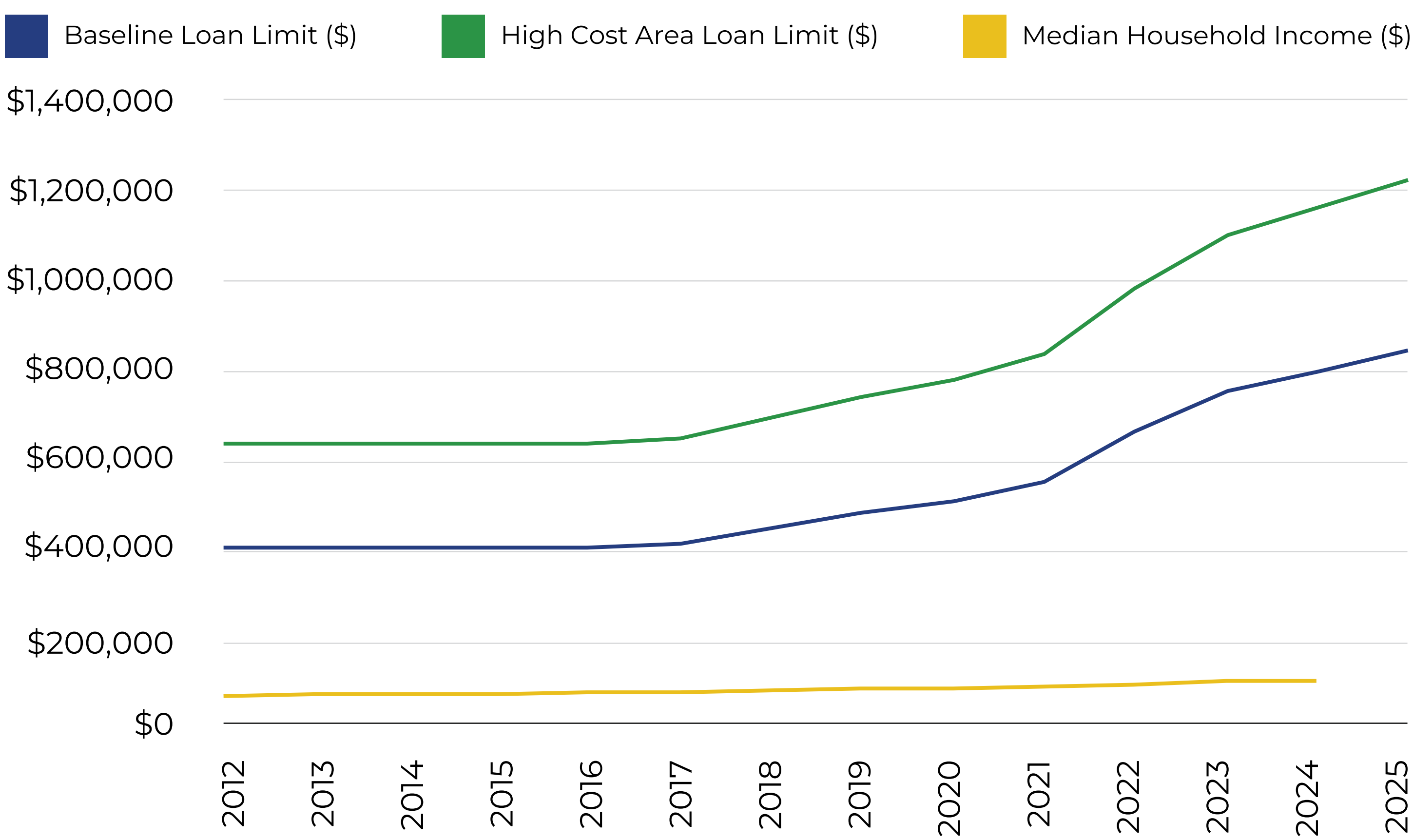
The Mechanical Statutory Increase of the Conforming Loan Limit (CLL)

The GSEs are tasked with ensuring liquidity in the mortgage market. As home prices have soared, with the median home price-to-income ratio approaching six nationally, the statutory limits on loans they can purchase mechanically increase to keep pace with inflation and prevent the housing finance system from seizing up. While necessary to support liquidity, the mechanical increase of the CLL is a reactive measure that tacitly ratifies current high prices, enshrining a status quo where homeownership costs are dramatically inflated. This constant push-up of limits ensures that the price gains driven by supply shortages are continuously integrated into the federally-backed system.

The Institutional Investor Bid

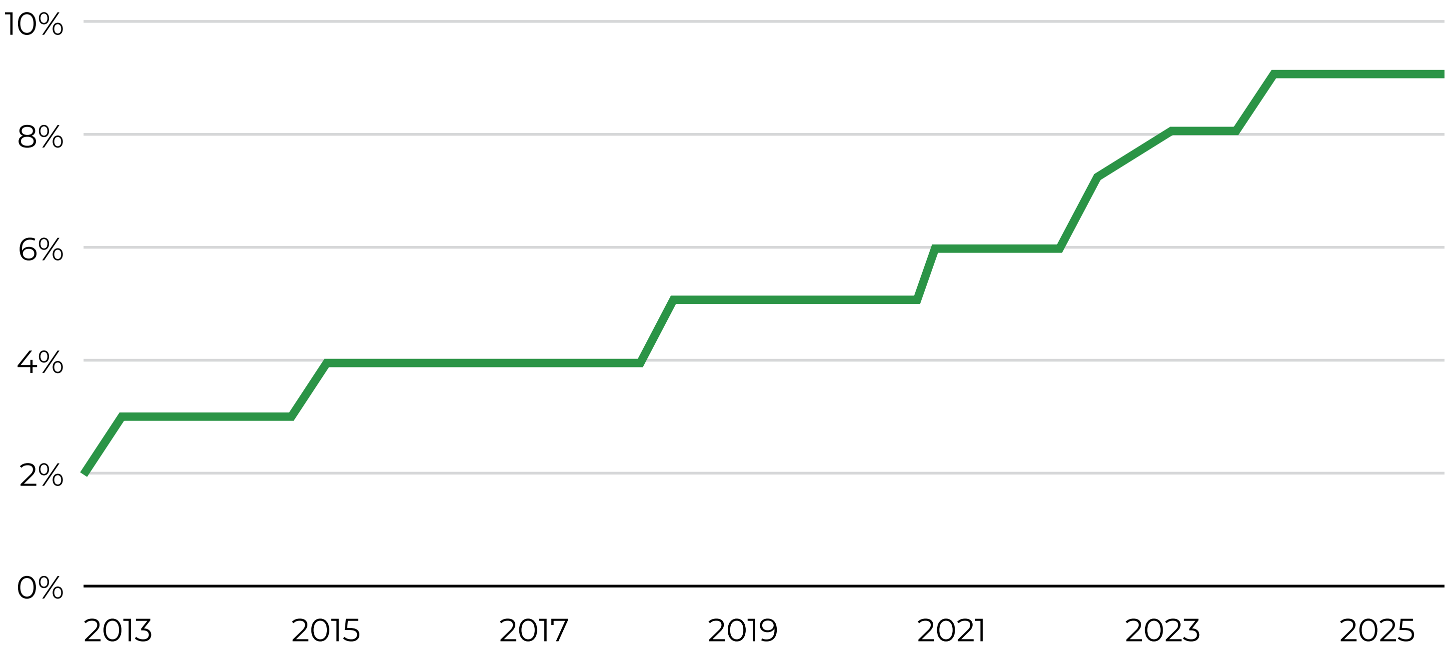
The status quo is characterized by a residential rental market that has become more professionalized and sophisticated with a new set of investors focusing on maximizing revenues. This dynamic sometimes sidelines potential first-time buyers who must compete against sophisticated bidders, accelerating the trend that has delayed homeownership until age 40 for the median first-time buyer. The persistent lack of affordable housing, and specifically the decline in new single-family homes under 1,400 square feet, ensures that the competition remains fierce, leaving LMI households increasingly vulnerable to being priced out.

LOAN LIMITS AND HOUSEHOLD INCOME OVER TIME



Sources: Census Bureau, FHFA, Pennymac

% OF BORROWERS PAYING MORE FOR TAXES AND INSURANCE THAN PRINCIPAL AND INTEREST



Source: Cotality, Pennymac

Rising Insurance and Tax Costs

Housing costs are increasing not just due to construction and financing, but also from rising operating costs and localized risk. Weather disasters are increasing in frequency, leading to spikes in insurance premiums for single-family homeowners and apartment buildings alike, with some insurers exiting the market altogether. These high insurance premiums add significant costs to development budgets. Moreover, the rising cost of operations, especially insurance, is putting existing affordable housing stock at risk of being lost. This crisis could ultimately require a national response, which could include models such as a federal reinsurance backstop.

50-Year Mortgage Concerns Likely Outweigh Any Potential Benefit

While new mortgage products are often proposed with the goal of enhancing affordability, the 50-year mortgage proposal presents significant operational challenges and financial drawbacks that outweigh the benefits, rendering the product more theoretical than viable.

The primary operational concern is the lack of TBA eligibility. A 50-year term introduces a new, non-standard maturity, which breaks the homogeneity required for the TBA market. Since the TBA market is critical for providing the massive liquidity that keeps mortgage rates low, non-TBA-eligible securities trade at a persistent price discount. This discount, combined with the premium investors will seek for the extended duration risk, translates directly into higher interest rates for borrowers.

Thus, the financial trade-off for borrowers is notably unfavorable. The product offers only a small reduction in the monthly payment in exchange for significantly higher lifetime interest payments. Crucially, this would drastically slow the pace of equity accumulation, restricting borrowers' financial mobility and increasing the risk of being underwater should home values decline.

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