

Banking and Finance Law Daily Wrap Up, GOVERNMENT SPONSORED ENTERPRISES—FHFA seeks comment on Freddie Mac product to buy certain second mortgages, (Apr. 17, 2024)

Banking and Finance Law Daily Wrap Up

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By Justin Marcus Smith, J.D.

The FHFA notice said “Freddie Mac believes the proposed new product may advance its charter act purposes by providing liquidity and stability in the secondary mortgage market.”

The Federal Housing Finance Administration (FHFA) has identified a Freddie Mac proposal to purchase certain closed-end second mortgages on properties for which it already holds the first mortgage as a “new product” meriting [notice and comment](#) in the public interest. Comments are due 30 days after publication of the notice in the *Federal Register*.

FHFA Director Sandra L. Thompson [said](#) the proposal is meant to “provide homeowners with a cost-effective alternative for accessing the equity in their homes.” Targeted sellers would be all lenders currently offering closed-end mortgages or who plan to offer them in the near term. Freddie Mac expects to be able to provide sellers with pricing to enable them to offer rates competitive with those for closed-end second mortgages. The FHFA said it must review and approve this proposal as an Enterprise activity under section 1321 of the Safety and Soundness Act, so it is undertaking a public notice and comment period to that end. The agency said it expects the proposed product to be beneficial to homeowners, lenders, and investors in mortgage backed securities (MBS).

Stated objective. The FHFA notice suggested that existing borrowers “face limited options” to access home equity in the current housing market. Limiting factors include higher mortgage rates; low housing supply; and, continued price appreciation. It said traditional cash-out financing, which involves the refinancing of an entire outstanding loan balance, may be a big hurdle for people who initially bought or refinanced at lower mortgage rates.

As a lower cost alternative, Freddie Mac proposes to purchase certain closed-end second mortgage loans from primary market lenders. The lenders would be approved to sell mortgage loans to Freddie Mac. In a closed-end second mortgage loan, the borrower’s funds are fully disbursed at closing, and the mortgage is recorded in a junior lien position in land records. Purchase parameters are aimed at minimizing credit risk to Freddie Mac while giving existing homeowners potential cost savings.

Parameters. As proposed, Freddie Mac will only buy a second mortgage on a fixed-rate, fully amortizing loan, up to a 20-year term, where it currently owns the first mortgage. Land trusts and co-operative share mortgages would be ineligible. There are to be limitations on the number and aggregate unpaid principal balance of Freddie Mac purchases for an initial evaluation period.

Second mortgages are to be initially delivered through the Cash Window. Freddie Mac would initially provide “spot bids,” not forward prices. Loans would remain in portfolio for about six to nine months until securitization and to implement systems to allow for evaluation of credit risk transfer in later phases.

Servicing requirements, including loss mitigation servicing, would be similar to those applicable to first mortgages. Freddie Mac could holistically review the performance of both loans. FHFA suggested this, alone, would have benefits. Manual underwriting would pertain initially. The maximum Total-Loan-to-Value would be 80 percent, or 65 percent for manufactured homes, not to exceed the maximum for a cash-out refinance mortgage. Refinancing of the first mortgage would require the second to be paid in full with the first mortgage, unless

prohibited by law. The Representation & Warranty framework for each mortgage would be applied independently to encourage independent and “holistic” quality control.

Potential impact. The FHFA presented example potential savings of around \$130 per month for a \$30,000 second mortgage, compared to cash-out refinancing, where the first mortgage initial terms at origination 9 years ago were 3 percent, compared to 7.5 percent if a cash-out refinancing originated today. Total interest savings to the homeowner would be more than \$100,000 in the hypothetical example provided. The FHFA notice suggested that the arrangement might attract more lenders to offer closed-end second mortgages, leading to more competition, more choices, better pricing, and further cost reductions.

The FHFA notice said Freddie Mac believes the proposal may not only advance its charter act purposes, it may also lower its own credit risk because of the shorter duration of second mortgages, relative to a typical 30-year cash-out refinance, when balanced against the cost savings provided to homeowners.

Mitigation. The FHFA said Freddie Mac would develop specific compliance and risk mitigation strategies for the proposed new product. FHFA suggested Freddie Mac would also gain more insight from two loans. Freddie Mac, not the servicer, would make mitigation or foreclosure decisions.

Securitization. Participating financial institutions who originate or buy closed-end second mortgages could securitize the loans or hold them on their balance sheet. The FHFA suggested current mortgage-backed securities (MBS) investors might experience slower pre-payment speeds, relative to cash-out refinancing, translating to lower payoff transaction costs and a more predictable and consistent rate of return. The FHFA notice suggested further that the arrangement could lead to greater standardization of secondary market transactions.

Comment sought. The FHFA sought public comment on nine discrete questions addressing whether the proposal will:

1. advance the Freddie Mac charter;
2. advance Freddie Mac’s duty to serve underserved markets and meet housing goals;
3. supply something already supplied by other market participants;
4. promote or lessen competition;
5. overcome natural market barriers or inefficiencies;
6. raise or reduce risks to the mortgage finance or financial system;
7. promote fair housing and fair lending;
8. benefit or harm borrowers;
9. implicate any other factors to be considered.

Companies: Freddie Mac

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