

Statement

Statement of Director Sandra L. Thompson on the Conditional Approval of the Freddie Mac Second Mortgage Proposal

IMMEDIATE RELEASE

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In April, the Federal Housing Finance Agency (FHFA) published a [notice of a proposed new product](#)  from Freddie Mac to purchase certain single-family closed-end second mortgages. This notice represented the first time a proposed new product from Freddie Mac or Fannie Mae (the Enterprises) was published for public comment under the process required by Congress and implemented through FHFA's "Prior Approval for Enterprise Products" [regulation](#) , which became effective in April 2023.

Today, FHFA issued a conditional approval for Freddie Mac to engage in a pilot to purchase closed-end second mortgages. Before discussing the details of the proposal and the review process below, I would like to express my appreciation for the many organizations and individuals that provided comments, as well as the FHFA staff that analyzed these comments. By statute, only 30 days are permitted for the public comment period, as well as 30 days following the public comment period for FHFA to approve or deny the offering of the new product. While these are shorter periods than those associated with some other public comment periods, I believe the process worked well and provided lessons for future new product proposals by the Enterprises.

The conditional approval was informed by the numerous comment letters received as well as considerations required by law:

1. The product is authorized under specified sections of Freddie Mac's Charter Act: The Freddie Mac Charter Act permits the Enterprise to purchase

“residential mortgages that are secured by a subordinate lien against a one- to four-family residence,” subject to certain conditions (See 12 U.S.C. 1454(a)(4)). The proposed new product meets the requirements for authorization under the Charter Act.

2. The product is in the public interest: As of December 2023, over 95 percent of Enterprise-backed single-family mortgages had mortgage rates below current market rates, with the majority at least 3 percentage points lower. Meanwhile, national home prices have doubled in less than a decade, leading to significant amounts of equity for many homeowners. Freddie Mac’s purchase of closed-end second mortgages is intended to allow borrowers to maintain their low interest rate first mortgage while accessing a portion of the equity in their homes. Several public interest factors were considered in the review process:

- Provide lower-cost alternatives to existing cash-out refinance products: Many borrowers – particularly low-income borrowers and those in rural and underserved communities – have struggled to access equity in their homes through the private home equity market. In an environment of elevated mortgage rates, they are either forced to give up their below-market rate and obtain a cash-out refinance with a higher mortgage rate across the entire loan balance or are forced to sell their home when a financial need arises, which can create instability for families and run counter to the Enterprises’ missions.
- Avoid crowding out private capital or producing unintended macroeconomic or mortgage market effects: FHFA anticipates that a pilot with a volume limitation of \$2.5 billion, a duration not to exceed 18 months, a maximum loan amount of \$78,277 (as adjusted annually in Regulation Z), a 24-month minimum seasoning requirement for the first mortgage, and eligibility only for principal/primary residences will allow analysis of consumer demand, lender offerings, servicer operations, and investor appetite in a controlled manner. The \$2.5 billion volume cap, in particular, is responsive to concerns from several commenters regarding the potential macroeconomic and mortgage market impacts of a broader offering. Some commenters

cited estimates of \$500 billion or more in second mortgage volume if the Freddie Mac proposal were approved, but the volume cap of the approved pilot instead represents *less than one half of one percent* of these estimates. This is intended to mitigate any concerns about potential inflationary impacts, extending the mortgage “lock-in” effect, or the “crowding out” of private capital.

- Benefit underserved borrowers: FHFA anticipates that a pilot with a per-loan limitation of \$78,277 (as adjusted annually in Regulation Z) will appropriately target rural and underserved borrowers. The average loan size of closed-end second mortgages is nearly half of the average loan size of home equity lines of credit (HELOCs). Since borrowers in underserved communities (such as lower-income borrowers or those in rural areas) carry smaller balances, on average, HELOC providers may overlook these borrowers in favor of higher-income borrowers and others currently well-served by the home equity market. Thus, a per-loan cap on closed-end second mortgages could potentially expand access to home equity products for underserved borrowers who otherwise would need to obtain a less economical cash-out refinance or utilize other higher-rate consumer credit options.
- Broaden participation in the home equity market to smaller financial institutions that can effectively serve their local communities: FHFA believes there are segments of lenders that have struggled to access a secondary market for home equity products – HELOCs and closed-end second mortgages – outside of cash-out refinances eligible for sale to the Enterprises. Current home equity lending is primarily supported by larger depository institutions that tend to hold whole loans on their balance sheets, while securitizations of home equity loans remain limited. FHFA is interested in learning whether this offering will be utilized by small community financial institutions that have more limited access to securitization markets. If so, this offering could support broader lending in underserved communities, while promoting greater competition among lenders and greater choice for consumers. This will be one of the many factors FHFA will examine upon the conclusion of the Freddie Mac pilot.

3. The product is consistent with the safety and soundness of Freddie Mac or the mortgage finance system: While the volume cap ensures that any second mortgages acquired through the pilot would represent a small fraction of Freddie Mac's aggregate loan acquisitions, FHFA also approved the limited pilot subject to additional safety and soundness considerations:

- Pricing and capital treatment: FHFA expects that the pricing of eligible second mortgages, as well as the capital requirements associated with them, will appropriately reflect the risks that they pose. This should also mitigate the risk that Freddie Mac will displace activity already occurring in the home equity market, which is primarily concentrated in offerings to higher-income borrowers, as the objective is to reach borrowers who otherwise would be subject to more expensive alternatives, such as a cash-out refinance.
- Eligibility parameters: Further, as is required of cash-out refinances purchased by the Enterprises, the maximum combined loan-to-value ratio of the first and second mortgages cannot exceed 80 percent, ensuring a robust equity position for the borrower to protect against a decline in home prices. And unlike a cash-out refinance, which for most borrowers in the current environment would entail resetting the entire mortgage balance at a higher interest rate, a second mortgage allows borrowers to maintain an existing low interest rate first mortgage. In many cases, this would lead to a lower overall monthly mortgage payment relative to a cash-out refinance, thereby improving mortgage sustainability.

Finally, FHFA will use this inaugural new product proposal to find ways to improve the public review process for future Enterprise submissions. While the length of the public comment period and the FHFA review period are subject to statutory limitations, FHFA remains open to additional ideas and feedback from stakeholders on ways to improve this process over time.

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