American Bankers Association

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SENT VIA ELECTRONIC MAIL

May 20, 2024

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
400 Seventh Street, SW
Washington, DC 20024

RE: Proposed Enterprise New Product; Comment Request 'Freddie Mac Single-Family Closed-End Second Mortgages' (No. 2024-N-5)

Dear Director Thompson:

The American Bankers Association[1] appreciates this opportunity to comment on the Federal Housing Finance Agency s' (FHFA) request for comment on a new product proposal by Freddie Mac to purchase single-family closed-end second mortgages on which Freddie Mac already owns the first lien.

As FHFA notes, Section 1321 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, as amended (the Act) requires Fannie Mae and Freddie Mac (the Enterprises) to seek prior approval from FHFA before introducing new products. The Act also requires the Director to provide an opportunity for the public to comment on a new product as part of the required determination of whether the product is in the public interest. Other relevant factors the Director must consider include whether the product is authorized for the relevant Enterprise and if the product is consistent with safety and soundness requirements for the Enterprises.

Based upon these criteria and ABA's analysis of the information provided by Freddie Mac and FHFA, ABA opposes approval of this new product. Our opposition is based on our assessment that:

- The new product does not meet a need that is not already being met by the private market;
- Freddie has not demonstrated that the program will bring cost savings to borrowers that is not already being provided by the private market;

[1] *The American Bankers Association is the voice of the nation's $23.7 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $18.8 trillion in deposits and extend $12.5 trillion in loans.*

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- It will not benefit Low to Moderate Income borrowers consistent with the broader mission of the Enterprises;
- It is not likely to bring greater stability to the primary mortgage market – and indeed may threaten stability.

In addition to these substantive concerns, ABA has procedural concerns that FHFA should address both about this proposal and before considering any future new product proposals from the Enterprises.

Substantive Concerns

Demand for closed-end second liens has increased in recent years, likely driven by higher interest rates which lead borrowers to seek such loans rather than a cash-out refinance. Home Mortgage Disclosure Act (HMDA) data show a decrease in total originations but a dramatic increase in junior liens in 2022. While total originations went from 13,696,000 in 2021 to 6,729,000 in 2022, junior liens increased from 228,000 in 2021 to 360,000 in 2022. (see Figure 1 in Appendix)

The Freddie Mac proposal published by FHFA offers no data to support an assertion that the private market is not sufficiently meeting the demand for these second liens. While our members report growing demand for second liens, they have not raised concerns about insufficient capacity to hold these loans in portfolio or a lack of alternative outlets if they do not wish to hold them. A recent report[2] from *Inside Mortgage Finance* notes that an affiliate of Pacific Investment Management Company (PIMCO) is preparing a $365.4 million securitization of closed end second liens and a second report[3] that Rocket Mortgage has recently marketed a $445 million securitization. Both reports show a strong private market exists for these loans. This suggests that the new product proposal is not based upon primary market need; rather, Freddie Mac may be pursuing an opportunity to generate additional business through an alternative product at a time when its broader business may be down due to higher interest rates and lower first lien originations.

The request for comment states that "Freddie Mac has indicated that the primary goal of this proposed new product is to provide borrowers a lower cost alternative to a cash-out refinance in higher interest rate environments." However, as noted above, Freddie has not shown any failure of the private market to meet the demand for second liens, and it is not at all clear that the entrance of Freddie Mac into this market would reduce costs for homeowners. While it is clear, as the proposal asserts, that for most borrowers a closed end second lien is more affordable than a cash out refinance given current interest rates,

[2] https://www.insidemortgagefinance.com/articles/230864-pimco-gets-into-second-lien-securitization-market?v=preview

[3] https://www.insidemortgagefinance.com/articles/231005-rockets-securitization-of-second-liens-humming-along?v=preview

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Freddie and FHFA have not provided enough data and information to assess whether Freddie's purchase of these liens would generate any additional cost savings to borrowers over that provided by the private market. Indeed, our members believe they can provide borrowers with lower closing costs for second liens held in portfolio than they may be able to offer on liens sold to Freddie under this program. For example, many portfolio lenders originate second liens without new appraisals, formal title updates and other requirements which may still be required by Freddie Mac, saving borrowers these closing costs. Prior to approving the new product, FHFA should require Freddie Mac to provide specific details about closing requirements for these loans, which demonstrates that the new product will in fact provide borrowers with cost savings not currently available from portfolio lenders operating in this well-functioning and competitive private market.

Moreover, the proposed product is not likely to benefit low- and moderate-income borrowers. HMDA data from 2023 shows that borrowers applying for a second lien had higher average annual incomes than borrowers applying for a first lien ($110,000 versus $96,000) (see appendix 2). This data suggests that the main beneficiaries of the new product would be higher income existing homeowners, especially considering that the average second lien borrower has an income well above $85,767 which is the current cutoff for low to moderate income using the Enterprises metric of 115 percent of average median income.[4] The proposal also notes that eligible second liens on manufactured housing would be limited to 65% LTV (Loan to Value). While we recognize the safety and soundness reasons for this limitation, this further limits the efficacy of such a program for lower income borrowers more likely to own a manufactured home. We question whether it is an appropriate use of Freddie Mac's GSE (Government Sponsored Enterprise) preferred status to be providing such a benefit to higher income homeowners who have already benefitted through the Freddie purchase of their first lien, rather than using that GSE status to expand affordability to lower income borrowers seeking to buy their first home.

A generous interpretation of the new proposal could be that income generated by Freddie Mac from the new program could be used to cross subsidize such lower income new borrowers, but again, the actual proposal provides no such details or even suggestion of that intent.

Providing an outlet for second liens does not advance affordable housing; instead, it benefits existing homeowners seeking to access equity in their existing home. As demonstrated during the financial crisis of 2007-2008, encouraging access to that equity can be bad public policy and can threaten market stability. Despite the dramatic increase in home values in recent years, home values do not always increase, and can decrease, sometimes rapidly. Providing government backing for second liens removes a level of

[4] https://www.fanniemae.com/research-and-insights/perspectives/low-income-homeownership-and-role-state-affordable-mortgage-programs-perspectives-may-17-2018

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market discipline, which reduces concerns about potential losses in value and the potential for default. In contrast, loans held in portfolio are likely to face greater scrutiny and more stringent underwriting from lenders before being made.
Additionally, a recent report[5] issued by the Financial Stability Oversight Council (FSOC) highlights concerns about the risks to financial stability presented by non-bank mortgage servicers and originators. The report observes that non-bank mortgage companies currently originate two-thirds of mortgages and service more than half of the outstanding mortgages. The urgent FSOC concerns outlined in this report—that vulnerabilities could amplify shocks to the mortgage market and pose risks to financial stability— are not at all discussed, nor apparently considered, by FHFA's request for input. The market reality that appears to be entirely overlooked by this proposal is that it is largely non-bank mortgage companies that stand to gain from this new product. This proposal, when combined with the FSOC's findings, beg the question asked by the Wall Street Journal Editorial Board[6]: why help these nonbank mortgage companies expand into new markets with this new product that could add risk to taxpayers and the broader financial markets.

ABA also questions whether it is appropriate for Freddie Mac to consider this product while still in conservatorship and still lacking sufficient capital to back even their existing book of business. While strides have been made by both Enterprises under the guidance and conservatorship of the FHFA under multiple administrations, it remains a fact that the Enterprises have not been sufficiently recapitalized and that permanent reforms (preferably locked in through legislation) have not been enacted. Absent sufficient capital, and any information about guardrails or other protections that Freddie would put in place to ensure that appropriate underwriting and other foreclosure avoidance protections are in place, approving this product could be destabilizing to the market and the financial system.

Process Concerns

From a process standpoint, FHFA needs to reconsider the agency's approach to both this proposal and any future proposals from the Enterprises for new products. The nine questions posed by FHFA in the request for comment should be posed to Freddie Mac and answered by the Enterprise in advance of any publication of a proposal for public comment. Without specific information from Freddie Mac about the market they intend to serve, data on the private market failure they seek to address; guardrails that will be put in place to protect safety and soundness; and a justification for why the Enterprise's GSE status should be leveraged for this purpose while still lacking sufficient capital to cover their existing book of business.

[5] https://home.treasury.gov/news/press-releases/jy2331
[6] https://www.wsj.com/articles/yellens-new-too-big-to-fail-firms-mortgage-housing-market-43c47f35

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For the reasons stated above, FHFA should not approve this proposed product. Moreover, going forward FHFA should reconsider their approach to the public comment process and require the Enterprises to provide relevant details before seeking public comment.
We appreciate this opportunity to comment, but strongly urge FHFA to reject the current proposal from Freddie Mac.

Sincerely,

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Appendix

Figure 1: Applications, Originations, Pre-Approvals, And Loan Purchases, 2022 (In Thousands)

(Source: CFPB)

	Home Purchase					Refinance					Total[1]				
	2018	2019	2020	2021	2022	2018	2019	2020	2021	2022	2018	2019	2020	2021	2022
A. Closed-end excluding reverse mortgage															
SITE BUILT 1-4 FAMILY															
Applications	5,652	5,837	6,453	6,977	5,852	3,708	5,803	13,216	13,097	4,330	10,060	12,373	20,262	20,700	11,021
Originations	4,136	4,307	4,693	5,127	4,129	1,880	3,381	8,423	8,280	2,220	6,349	8,023	13,380	13,696	6,729
First lien, principal residence	3,594	3,736	4,101	4,378	3,533	1,605	3,052	7,849	7,605	1,902	5,330	6,928	12,088	12,137	5,565
Conventional[2]	2,410	2,489	2,755	3,097	2,542	1,245	2,292	6,416	6,309	1,528	3,774	4,907	9,303	9,553	4,192
Conventional conforming	2,222	2,311	2,591	2,846	2,344	1,180	2,144	6,227	6,066	1,468	3,514	4,575	8,942	9,048	3,925
Conventional jumbo	188	178	164	251	198	65	148	189	242	59	259	332	360	505	267
Nonconventional	1,184	1,247	1,346	1,281	991	359	760	1,433	1,297	375	1,556	2,021	2,785	2,584	1,373
FHA	712	752	796	754	576	188	343	485	514	192	909	1,106	1,286	1,272	773
VA	370	397	426	422	362	170	415	938	774	182	544	814	1,366	1,199	545
FSA/RHS	102	98	124	104	54	1	2	10	8	1	103	101	133	113	55
First lien, second residence	173	178	227	256	148	31	56	159	144	35	212	241	394	413	195
First lien, investment property	286	293	268	399	373	172	203	370	495	211	484	522	657	919	610
Junior lien, all occupancy types	83	100	98	94	74	72	69	45	36	72	323	332	240	228	360

Figure 2: Median Income of Mortgage Borrowers by Type of Lien, 2023

Category	Median Income
First Lien	$96,000
Second Lien	$110,000
All Borrowers	$100,000
Source:	HMDA, ABA Calculations