Congress of the United States
Washington, DC 20515

May 24, 2024

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, D.C. 20219

Director Thompson,

We are writing to express our concerns regarding Freddie Mac's proposal to purchase and guarantee single-family closed-end second mortgages. This proposed product, if implemented, will exacerbate inflation, disrupt the home equity lending and consumer credit markets, and increase risks to taxpayers, while providing no benefit to the many Americans who lack substantial home equity. We therefore urge the Federal Housing Finance Agency (FHFA) to reject this misguided and hastily executed proposal.

It is crucial to understand that second mortgages, such as home equity loans, are consumer loans that finance spending and consumption.[1] According to preliminary estimates, this proposal could lead Freddie Mac—and likely Fannie Mae—to finance hundreds of billions in additional equity extraction, which will only counteract the effects of tighter monetary policy and worsen inflation for Americans.

Furthermore, the proposal threatens to transform Freddie into a massive consumer loan guarantor that disrupts credit markets and crowds out private capital. A GSE-insured ("Government-Sponsored Enterprise") product that uses subsidized lending to offer reduced interest rates, extended loan terms, and lower monthly payments will have unfair advantages over private lenders and ultimately reduce diversification in home equity lending, second liens, home improvement, installment, auto loan, and other consumer credit markets. Government subsidization will not only enable the proposed product to offer terms that are economically impossible for private capital to match, but represents a vast (albeit indirect) expansion by the GSEs into these other credit markets.

The proposal also increases systemic risk. As consumers opt for this new GSE product and use it to consolidate existing debts, Freddie's balance sheet will absorb consumer loan risks directly linked to the housing market. Should home prices drop significantly, homeowners with second mortgages may default. While equity buffers typically help mitigate default risks, the decrease in equity buffers caused by this proposal would make defaults and foreclosures more likely. Additionally, the proposed product could raise the potential for stress in the banking system by making loan portfolios riskier. For example, as the most creditworthy homeowners use the

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[1] See fig. 7, Aladangady, Aditya, and Kelsey O'Flaherty (2020). "How Much Does Home Equity Extraction Matter for Spending?," FEDS Notes. Washington: Board of Governors of the Federal Reserve System, May 01, 2020, https://doi.org/10.17016/2380-7172.2535.

proposed product to consolidate consumer loans into second mortgages with lower interest rates, banks will then hold fewer high-performing loans to counterbalance losses from defaults.[2]

The proposal also fails to advance Freddie Mac's mission to improve housing affordability for low- and middle-income households. The proposed product will primarily help homeowners who possess meaningful equity in their homes and have already gained from the 68.9% increase in home prices since the pandemic.[3] It offers no benefit to renters or homeowners who lack meaningful equity, such as first-time homebuyers. In fact, the proposal is likely to adversely affect these Americans through its broader inflationary impact on the economy, as well as by exacerbating the rate lock-in effect, the adverse effects of which were reported on by the FHFA earlier this year.[4]

Finally, as a procedural matter, we note that the FHFA's New Product Rule follows the directives of the Housing Economic and Recovery Act of 2008 in providing a 30-day comment period for market participants and stakeholders to provide feedback on new products.[5] That 30-day period is clear evidence of Congressional intent regarding the scope of the kinds of proposals that the FHFA should review and approve. Here, a mere 30 days is insufficient for market participants to provide feedback on a proposal with such an outsized impact on the housing market, to say nothing of its potential impact on the overall economy. Thus, the unsuitability of a 30-day comment period in this instance is further evidence that the proposal is outside of the GSEs' mandate.

We are deeply concerned that the proposal is a thinly veiled attempt by the Biden administration to offset the effects of excessive fiscal spending and tight monetary policy as the November election approaches. The sole purpose of the FHFA's conservatorship of the GSEs is to restore their soundness and solvency so they can fulfill their statutory missions—under no circumstances should the FHFA's ultimate authority as a conservator be exploited for political purposes. The GSEs are already the largest mortgage guarantors in the country; expanding their roles as consumer loan guarantors is a significant step in the wrong direction.

Sincerely,

Bill Hagerty
United States Senator

Tim Scott
Ranking Member, Senate Committee on
Banking, Housing, and Urban Affairs

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[2] The Editorial Board, *Return of the Housing Godzillas,* Wall Street Journal (May 5, 2024), https://www.wsj.com/articles/return-of-the-housing-godzillas-fannie-freddie-biden-second-mortgages-f7ac7d77.
[3] S&P CoreLogic Case-Shiller U.S. National Home Price Index.
[4] Ross M. Batzer, Jonah R. Coste, William M. Doerner, and Michael J. Seiler "Working Paper 24-03: The Lock-In Effect of Rising Mortgage Rates" (March 18, 2024), https://www.fhfa.gov/PolicyProgramsResearch/Research/Pages/wp2403.aspx.
5 See Sec. 1321(c)(3) of the Housing and Economic Recovery Act of 2008 "PRIOR APPROVAL AUTHORITY FOR PRODUCTS". Public Law 110–289 (U.S.C. 4541).

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