May 22, 2024

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

Re: Freddie Mac Proposed Purchase of Single-Family Closed-End Second Mortgages (Docket No. 2024-N-5)

Dear Director Thompson:

Americans for Tax Reform (ATR),[1] and the undersigned organizations, have strong concerns with the Federal Home Loan Mortgage Corporation's (Freddie Mac) arbitrary plan to purchase single-family closed-end second mortgages. The proposal allows Freddie Mac to purchase second mortgages if it already owns the first mortgage.[2] The Federal Housing Finance Agency (FHFA) should reject the proposal because it is likely it will burden taxpayers with backstopping future losses on mortgage payments, which will be used to justify tax increases in the future. The proposal will also incentivize homeowners to acquire two mortgages—saddling Americans with unnecessary debt.

The proposal weakens stability in mortgage financing. Providing lower cost options for borrowers via government intervention will only distort the balance of supply and demand in the U.S. housing market. It also encourages borrowers to take on more debt. If it so happens that a borrower is unable to make payments on a second mortgage, Freddie Mac would have to absorb the losses. Ultimately, taxpayers bear the brunt of these losses because Freddie Mac has been in conservatorship for over fifteen years and is backstopped by stock warrants owned by the U.S. Treasury Department.[3] One article points out that "[t]axpayers are standing behind some $9 trillion in mortgages. As government grows, so does the taxpayer backstop."[4] If the proposal is finalized Freddie Mac would be incentivizing borrowers to take on second mortgages instead of refinancing. This will crowd out private cash-out refinancing and increase borrowers' reliance on Freddie Mac-backed mortgage financing. Taxpayers, borrowers who prefer cash-out refinancing, and lenders that offer cash-out refinancing aim to lose the most.

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[1] ATR is a nonprofit, 501(c)(4) taxpayer advocacy organization that opposes all tax increases and supports limited government, free market policies. In support of these goals, ATR opposes heavy regulation and taxation of financial services. ATR was founded in 1985 at the request of President Ronald Reagan.

[2] 89 FR 29329.

[3] https://www.freddiemac.com/investors/faq#:~:text=As%20part%20of%20the%20agreement,new%20window)%20(FHFA).

[4] https://www.wsj.com/articles/yellens-new-too-big-to-fail-firms-mortgage-housing-market-43c47f35?st=dnb9popw12rsri9.

The provisions in the proposal would negatively impact competitiveness in the U.S. housing market. The proposal claims that Freddie Mac-backed second mortgages are a better option than cash-out refinancing in the current interest rate environment. However, FHFA fails to consider how these financing options would fare once the Federal Reserve (Fed) starts cutting the federal funds rate.[5] If the Fed starts cutting rates by the end of 2024, the option for cash-out refinancing may turn out to be a better option for borrowers. Instead of emboldening government power when monetary policy is tight, FHFA should step back and allow the market to dictate the supply and demand equilibrium in the housing market. Until Freddie Mac is released from conservatorship, every decision implicates taxpayers and conditions the market to expect government backstops. This creates a significant moral hazard problem. The market has "perceived the GSEs' credit guarantee to be as good as a government guarantee because of the tight link between the GSEs and the federal government."[6]

The proposal recklessly claims that Freddie Mac can securitize second mortgages and thus limit the amount of risk it will hold on its balance sheet. One paper finds that "the current practice of government-sponsored securitization can exacerbate the intensity and frequency of financial crises."[7] Depository institutions are more likely to leave less risky mortgages on their balance sheets to be compliant with regulatory capital requirements. This results in the creation of structured products composed of "mortgages with higher default risks."[8] Instead of limiting risk, the process ends up "undermining the goal of creating a safe asset."[9] The FHFA's statement that "credit guarantee and experience securitizing mortgage loans" is an advantage, falls short of an adequate justification for why Freddie Mac should be allowed to purchase second mortgages.[10]

FHFA should not let this proposal proceed. Economic uncertainty could lead to a situation where the Fed lowers interest rates at an unanticipated time. In a free market this may incentivize more borrowers to look at cash-out refinancing instead of second mortgages. If Freddie Mac is allowed to buy second mortgages, this will distort the U.S. housing market and subject borrowers and lenders to be more reliant on taxpayer-backed financing. A U.S. housing market that is teetering on the backs of the American taxpayer is a disaster waiting to happen.

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If you have any questions or need any additional information, please contact Bryan Bashur at bbashur@atr.org.

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5 89 FR 29331

6 https://www.nber.org/system/files/working_papers/w24844/w24844.pdf.

7 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4821449.

8 *Id.*

9 *Id.*

10 https://www.federalregister.gov/d/2024-08479/p-45.

Sincerely,

Americans for Tax Reform
Americans for Limited Government
Americans for Prosperity
American Commitment
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Competitive Enterprise Institute
Consumer Action for a Strong Economy
Free Enterprise Project, National Center for Public Policy Research
Frontiers of Freedom
Hispanic Leadership Fund
Less Government
National Taxpayers Union
Rio Grande Foundation
The American Consumer Institute
60 Plus Association
The American Association of Senior Citizens