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Global Markets Research

Research Alert

# US Freddie Mac's pilot program to buy 2nd mortgages

## Untapped potential amounting $32.7tn of owner's equity in real estate
## Limited impact given the caps during the pilot programme
## Could unleash $0.8tn in consumer spending if programme is made permanent or expanded

**Overview**

The US Federal Housing Finance Agency (FHFA) recently gave conditional approval to Freddie Mac to purchase certain single-family closed-end second mortgages. The pilot program will be limited in scope, and FHFA will evaluate its success in helping borrowers, especially those in rural and underserved areas, before deciding whether to expand or make the program permanent.

**Opportune proposal to relieve the pain of US consumers**

The proposal could not have come at a better time. Most consumers in the US are feeling the pain of persistent inflation and this, if implemented effectively, could be a lifeline for these households, allowing selected borrowers access a portion of their home equity for spending without sacrificing their low-rate first mortgage, and offering them financial flexibility.

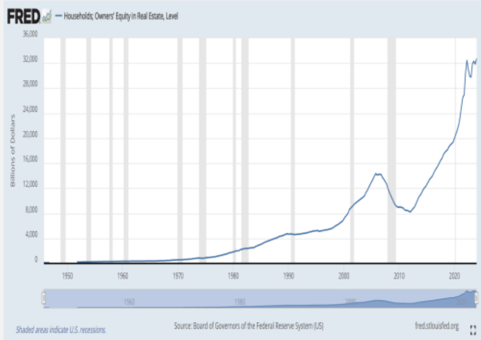
Just a recap, as of end-2023, over 95% of Enterprise-backed single-family mortgages had significantly lower interest rates than current market offerings. Meanwhile, home prices have soared over the decade, leaving many homeowners with substantial equity they could tap into for consumer spending.

- The cap in the pilot programme mitigates impact on potential inflation pressures or crowding out of private capital.
- Many homeowners, especially those with low incomes, living in underserved area and who typically need smaller loans, have had difficulty accessing their home equity through private lenders. With high mortgage rates, they face tough choices - refinance at a higher rate or sell their home to meet financial needs - contradicting the mission of affordable housing.
- At the same time, the FHFA hopes this pilot program will open up opportunities for smaller lenders to participate in the home equity market, which could lead to increased lending in underserved communities, more competition among lenders, and ultimately greater choice for consumers.
- However, as mentioned above, the conditional approval of the pilot includes several limitations like:
  - Maximum volume of $2.5bn in purchases
  - Maximum duration of 18 months for the pilot programme
  - Maximum loan amount of $78.3k per loan
  - Minimum seasoning period of 24 months for the first mortgage (first mortgage has been in place for at least 24 months)
  - Only for principal/primary residences

**Impact will be limited but could unleash the next US stimulus**

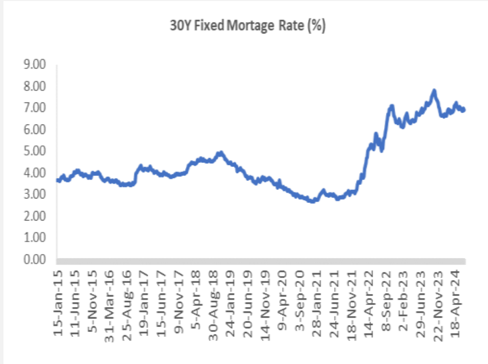
Given its cap of $2.5bn, US real GDP and personal consumption expenditure (PCE) of $22.4tn and $15.4tn in 2023, which accounted to 11.6% and 16.2% of GDP and PCE, this will hardly put a boost on consumer spending or GDP. However, should the scope be expanded or the program made permanent, our calculation suggests that this could potentially unleash $0.8tn of home equity into consumer spending and GDP,

**Figure 1: Households; owner's equity in real estate has reached $32.8tn as of 1Q**



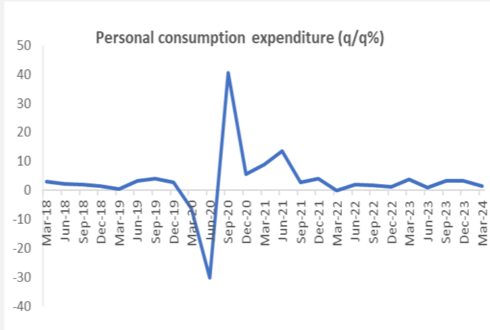

*Source: Federal Reserve Bank of St Louis*

**Figure 2: Mortgage rates have ticked up to 6.89% as of early July**




*Source: Freddie Mac*

**Figure 3: Private consumption has slowed, although remained resilient**



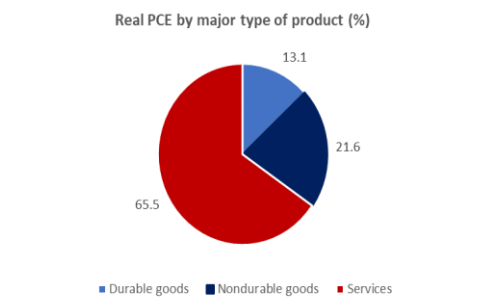

*Source: Bloomberg*

assuming take-up from the bottom 50% of households which held only 2.5% of total household wealth.

Our calculation is based on the assumptions below:

- While Americans are sitting on $32.8tn of accumulated equity in real estate, an untapped potential for home equity lending, the impact will be much smaller than this.
- Based on the St. Louis Fed's Institute for Economic Equity data, the top 10% of households by wealth had $6.7m on average. As a group, they held 66.9% of total household wealth. However, this is not the targeted group and we do not expect any take-up from this group.
- The bottom 50% of households by wealth had $50k on average. As a group, they held only 2.5% of total household wealth. This is the targeted group and potentially the biggest beneficiary.
- Assuming the same bottom 50% of households by wealth only accounts got 2.5% of equity in real estate, this translates to $0.8tn of home equity, or 4% of US GDP and 5% of PCE.

**Figure 4: Bulk of PCE spent on services like food services & accommodation, transportation, healthcare, financial services, recreating, housing and utilities**




*Source: BEA*

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