The Hon. Lael Brainard
Director of the National Economic Council and
Assistant to the President for Economic Policy
The White House
1600 Pennsylvania Avenue, NW
Washington, DC 20500

The Hon. Janet Yellen
Secretary, Department of the Treasury
1500 Pennsylvania Avenue NW
Washington, DC 20220

October 12, 2023

Dear Secretary Yellen and Director Brainard:

We write to propose a solution that will reduce the historically high long-term mortgage rates relative to long-term Treasury bonds. Housing accounts for nearly 20 percent of GDP and affects all homeowners, and renters, especially those in underserved and rural communities. Action is critical to address homeownership affordability and lending challenges and reduce impediments for servicers to loss mitigation efforts to keep defaulted borrowers in their home.

Specifically, we seek actions to reduce the historically wide spread between 30-year mortgage rates and 10-year Treasuries (30/10 spread), which could reduce mortgage rates by 100 to 150 basis points. More so, we believe the regulators must address the secular and structural decline in demand for mortgage-backed securities. We recommend the following actions that could help address this issue:

(1) The Federal Reserve shifting its policy to maintain its stock of MBS and suspend runoff until liquidity and the spread between the 30-year fixed rate mortgage and 10-year Treasury stabilizes, and

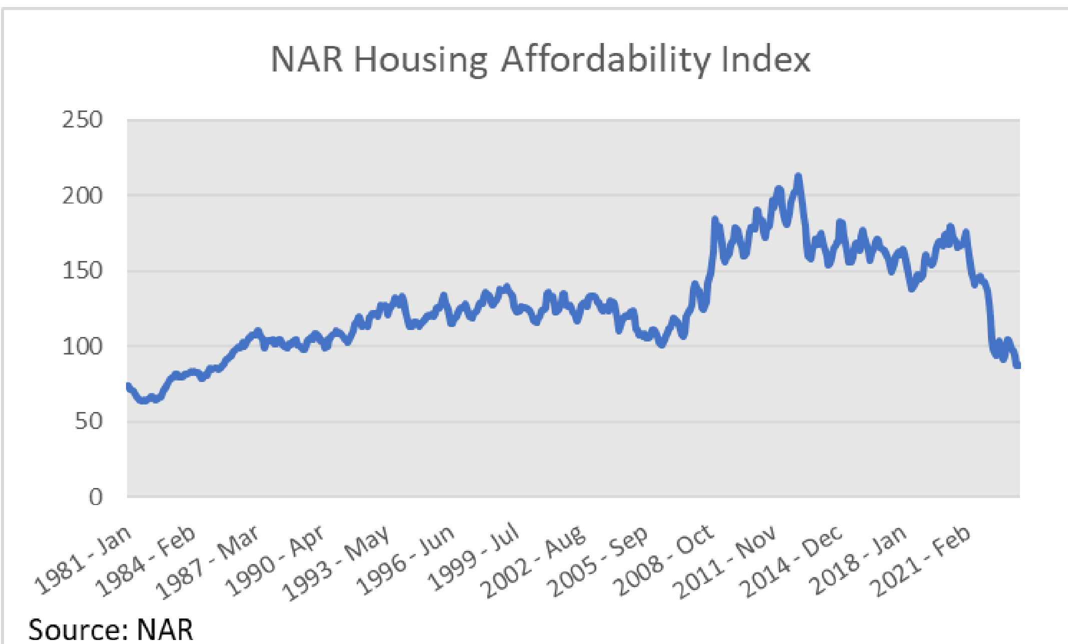
(2) Amending the PSPA agreements to enable Fannie Mae and Freddie Mac, on a temporary basis, to purchase their own MBS and/or Ginnie Mae MBS for a defined period of time.

Notes: The mortgage spread is defined as the 30-year mortgage rate minus the 10-year Treasury rate. The gray bars indicate NBER recessions.
Source: FRED and author's calculations.

According to the St. Louis Fed, current 30-year fixed rate mortgages, the **"30-Year Fixed Rate Mortgage Average"** in the U.S. as of September 21, 2023 was 7.19 percent. This is 2.7 times the average mortgage rate of 2.67 percent on December 17, 2020. Furthermore, the spread between the 30-year fixed rate mortgage and the 10-year Treasury is historically wide. As depicted above, that spread sits at just over 300 basis points as compared to the historic norm of roughly 150 basis points.

This extra cost has had a significant negative effect on the ability of a family to qualify for and purchase a home, particularly for 1st-time homebuyers. Additionally, according **to National Association of REALTORS®,** this strain on affordability has also played a key role in a 15.3 percent decline in home sales in August 2023 compared to a year ago. These developments limit economic growth and are harmful for housing and mortgage markets.

Moreover, our groups agree that taming inflation is a high priority and appreciate the Federal Reserve's decisive and effective action to staunch inflation, even as that effort has resulted in short-term rates at 22-year highs. However, low levels of construction over the last decade have left the market with a housing shortage of 5 million units, which effects both home prices and rents. Combined with the surge in mortgage rates, NAR's housing affordability index plummeted to near all-times lows. The housing shortage is structural for the time being and has a significant impact on inflation. Our groups thoroughly respect the independence of the Federal Reserve but believe it should take this structural issue into consideration when evaluating strategies to attain the Fed's desired 2.0 percent inflation target. While federal regulators do not have direct influence on many local construction issues, they can affect affordability for homebuyers and homeowners through the 30/10 spread.



In addition, banks have been saddled with low coupon mortgage-backed securities. These low-yielding assets weigh on their lending decisions as they require additional capital. Renewed activity by the Fed, or even direct purchases from banks, could shift bank demand to new MBS issuance and lowering rates while simultaneously putting banks in a better position to deal with the impending reset waive of commercial MBS.

Further, the exceedingly high mortgage rates make it extremely costly for mortgage servicers to pull older low interest loans out of mortgage pools in order to execute loss mitigation actions like partial claims to keep defaulted homeowners in their homes. We appreciate recent actions by the Federal Housing Administration (FHA) to try to avoid servicers having to take older low interest loans out of pools to do loss mitigation. However, this need still exists. Unnecessarily high mortgage rates create disincentives for servicers to take such loss mitigation actions and exacerbate losses for servicers that take such actions.

It is worth noting that renewing activities to support demand for 30-year MBS – and reducing the current artificially inflated 30-year MBS yields – will not undermine the overall impact of the Fed's actions to increase short-term rates and combat inflation. Likewise, MBS bought at current 6 percent coupons would be much easier to liquidate than 1 percent to 3 percent coupons purchased two years ago. Finally, the Fed's holdings are constantly reduced by runoff from loans paying off and paying down. At a minimum, the Fed should be buying MBS to at least offset this runoff.

For some 40 years, the Federal Reserve and Fannie Mae and Freddie Mac have acted as buyers of last resort for MBS to stabilize mortgage rates at times and ways that are appropriate. U.S. banks, foreign central banks, overseas banks, and insurance companies have recently moved away from buying MBS. As Laurie Goodman has noted, historically, the GSEs' portfolios have acted as "shock absorbers" to disruptions in the MBS market.[1] We believe this is an appropriate time for the Federal Reserve or Fannie and Freddie to step in and address this secular decline in demand for MBS.

Again, the Federal Reserve's monetary stance and inflation-fighting strategy are appropriate. Likewise, reasonable limits on the GSEs' portfolios are appropriate and necessary. Our groups simply urge action to address the strain on liquidity in the market for MBS through the purchase and holding of 30-year fixed rate mortgages. Doing so will help ease the nationwide affordability and lending difficulties while addressing servicing and loss mitigation challenges.

We thank you for consideration of this letter, and we would be happy to discuss any of these issues at your convenience.

COMMUNITY HOME LENDERS OF AMERICA

INDEPENDENT COMMUNITY BANKERS OF AMERICA

NATIONAL ASSOCIATION OF REALTORS®

CC:

The Hon. Jerome Powell
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The Hon. Sandra Thompson
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Federal Housing Finance Agency
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[1] Goodman, Laurie. "*The Answer to a Puzzle Behind Today's High Mortgage Rates*". Barrons Magazine. December 2022. https://www.barrons.com/articles/high-mortgage-rates-10-year-treasuries-51671659050