

FANNIE MAE'S

# CHANGING PLAYING FIELD



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To the casual observer, the home mortgage system, at least the governmentally influenced sectors, are paving the way for a recovery. The FHA is poised to become the replacement for subprime, the “white knight” agency that will provide insured liquidity for worthy borrowers to get into homes that previously were too expensive for FHA, opening up markets that were previously excluded. Freddie Mac and Fannie Mae were once thought to be redundant entities that received too generous a tax break from the federal government. Now, of course, they are perceived very differently. Fannie Mae is deemed the elder sibling that will lead the nation from the darkness of accounting scandals and grossly overpaid executives into the light of post-meltdown prosperity. At least that is how it appears to the casual observer. To others, it's a bit different and more than a little scary, particularly to originators who count on Fannie Mae to be the ballast in a business that desperately needs stability.

It seems more and more that Fannie is expected to be all things to all people. The agency is supposed to absorb much of the refinance pressure from all the resetting ARM subprime loans, keep its risk profile under control, support low down payment programs, expand its lending parameters to include high balance loans as the new definition of conforming, fund the majority of FHA-insured loans, also high balance now, and is supposed to keep its stock price at reasonably robust levels. It's a lot to ask, don't you think? We established a few years ago that some of its senior people aren't as smart as they thought they were; can we expect the agency to single-handedly save the entire American mortgage industry?

Originators need to be concerned. Fannie Mae, long the most important GSE to brokers and other mortgage originators, has never been as important as it is now. What about FHA, you ask? Nope. It's Fannie. Remember, FHA is an insurance company, and it agrees to insure loans origi-

nated to a tightly matrixed set of requirements. This takes some of the pressure off the end investor, to be sure, but FHA is not absorbing any of the real capital risk. If things go sideways, FHA gets bailed out by the federal government. In theory, the same thing happens if Fannie needs help, but it's not the same in practice, and the government simply can't afford to cover all of Fannie's bills if the unthinkable happens. Analysts are concerned, too; rating agencies have downgraded Fannie due to recent losses and the prospect of additional loan losses over the next several years. But in a Woody Allen-esque investor reaction, the stock price went up because of Fannie's more important role going forward: it's like noting that while the food continues to be bad, the portions are getting *much* larger.

So while various political entities, including Fannie Mae's regulator, are getting on a bandwagon to promote the agency as the financial answer to the nation's woes, Fannie itself is making it clear that things are far from rosy. Daniel Mudd, Fannie's CEO, has expressed his opinion that losses will in all likelihood increase over the next 12 months. A first quarter loss of over \$2 billion may be just the tip of the iceberg, especially as Mudd noted that home prices had fallen much faster than the agency anticipated when it made its 2008 loss projections. None of this has stopped Fannie's regulator, The Office of Federal Housing Enterprise Oversight, from dropping Fannie's capital requirement from 20 percent of its total mortgage debt to 15 percent, and come September, from 15 to 10 percent if there are no particular adverse developments. There are those out there who feel putting Fannie Mae on the bubble like this threatens a worldwide financial crisis.

It is all sounding very political. Fannie is losing money and its stock sells for about half what it sold for a year ago, yet is being compelled to take on more risk with less capital. Congress desperately wants to pass a housing relief bill, but is stymied by an administration that wants tighter controls on the GSEs to give them more stability for the future. Along for the ride is the FHA, which finds itself on the political balance beam and under pressure to insure loans

with negative equity if the servicing rights owner agrees to write down principal balances to 85 percent of the current appraised value. Understandably, FHA Commissioner Brian Montgomery is less than thrilled at that prospect, claiming it forces taxpayers to foot the bill for bad loans and creates billions in new loans that are inherently risky. What's at stake in all this for originators? Just the future of lending in this country—and it all revolves around Fannie Mae.

Originators need to pay close attention to what Fannie is doing. This is not getting any easier to do, either. Fannie had a policy on declining markets that required a downward adjustment to LTV depending on where the property was located. Understandable, given that some markets have been hit harder than others. When various groups cried, "Redlining!" Fannie was forced to reconsider the policy last May, replacing it with a national down payment policy that reduces LTVs for one-unit primary residences to 95 percent for manually underwritten loans and 97 percent for DU underwritten loans. While this may be good for originators, it is another example of Fannie not being allowed to protect itself from risk because of its presumed public purpose. As of this writing, it is a somewhat hollow change made by Fannie, given that PMI companies and Freddie Mac still have declining market penalties, but those may change under political pressure, too.

Stuck between the rock of its financial realities and the hard place of politics, Fannie will presumably look for other ways to limit its risk, and these will provide challenges for loan originators to deal with as they go about their business. You can rest assured that this "Twilight Zone" ef-

fect will keep things interesting for those who make their living by trying to structure deals that fund. The best advice is to hang in there, despite the obstacles, and above all, follow the rules you are given. Those taking shortcuts, even with lenders who encourage a liberal interpretation of the rules, could find themselves in hot water. A prime example is with the strict FHA rule regarding compensation for non-FHA approved mortgage brokers. It is a not-so-well-kept secret that some lenders are circumventing the limitation on compensation by paying brokers a "consultant fee" for bringing them FHA loans. This is not illegal in and of itself, but it is a matter of whether the fee is "appropriate" for the service rendered. If it comes close to the normal fee a broker would realize if they were in fact FHA approved, it is no longer legal, and brokers and lenders alike face significant penalties. Originators should know by now that just because a lender says something is a good idea does not necessarily make it so. Expect penalties for illegal kickbacks to escalate as offenders are made examples of for the rest of the community.

Also expect more confusion on Fannie Mae announcements. They are becoming lengthier and more complex, and though they are not really intended to stump you, they are indicative of a vital agency trying to control its destiny when others would do it for them. The "new DU," version 7.0, for example, which rolled out in June, is tougher than the previous version, and you have no doubt noticed you are getting fewer deals approved for various reasons. Foreclosures, recently treated with a certain cavalier attitude, are securely on Fannie's radar screen; all is not forgiven after two years, as in the past. Foreclosures have

to be ancient history—five years for new loans (and 10 percent minimum down payment), seven years for cash-out refinances, and a sterling FICO score of 680 or better. In other words, full financial health for those with foreclosures, with the track record to prove it. For borrowers without a foreclosure on their records, the new starting point for credit scores is 580, except for a few specialized programs. Expect this to remain at least until politics become a factor once again, with consumer advocates and office seekers arguing that too many worthy people are being denied credit. Forget that Fannie was never chartered to help everyone with a pulse get a loan, or that this attitude led to the current crisis in the first place. Expect DTI calculations to become more conservative as Fannie strives to strengthen the portfolio. There will be fewer exceptions and more fees involved with getting them qualified. In general, DU will be Fannie's first line of defense, and as such, will be increasingly tougher to deal with. This may spur some deals to find their way to Freddie Mac, but probably not for very long. It is only a matter of time before Freddie tightens up Loan Prospector for the same reasons.

So pay attention and do your homework. Stay tuned to industry resources like *M.O.M.*, NAMB and Mortgage Currentcy.com to interpret the sometimes bewildering pronouncements that come from Fannie in the future. One thing is certain: a healthy Fannie Mae is a good thing for all of us, and in a very real sense, the whole world is watching. 🏠

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