GSEs Remain in Full Gear

Fannie Mae and Freddie Mac are a strong foundation for the mortgage industry

By Terry Mott

One of the most important foundational elements of the mortgage industry today is the partnership between lenders and the government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac. Regardless of how one views the GSEs — in light of their history, current conservatorship, taxpayer bailout and guidelines — their value in establishing and maintaining a robust secondary mortgage market is unarguable.

A flourishing secondary market has broadened the opportunities for affordable homeownership for millions of Americans who otherwise would have been unable to borrow. Today, the flexibility afforded by the GSEs, and the loan programs they provide, help keep the mortgage world moving smoothly.

Fannie Mae and Freddie Mac buy mortgages from banks and other originators, pool them and create mortgage-backed securities that are sold to investors through the secondary market. This secondary market increases the supply of money available for mortgage lending and increases the money available for new home purchases.

In addition to purchasing conventional home mortgages that are then securitized, Fannie Mae and Freddie Mac also provide qualified "direct lenders" and their client borrowers with access to versatile mortgage products. For example, Fannie Mae's HomeStyle renovation loan — unlike Federal Housing Administration (FHA) 203(k) and Limited 203(k) renovation loans — can be used for luxury items, such as swimming pools.

GSE background

Since their creation decades ago, the GSEs have provided liquidity to the housing market through a secondary market. This was needed because the primary sources of housing liquidity (thrifts and savings and loan institutions) had become insufficient and unreliable. Fannie Mae was created by Congress in 1938, during the Great Depression, as an amendment to the National Housing Act. Freddie Mac was established in 1970 to compete with Fannie Mae.

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Legislative acts over the past four decades have affirmed the GSEs' obligation to facilitate the financing of affordable housing for low- and moderate-income families. The GSEs' flexible underwriting guidelines, low downpayments and competitive interest rates have expanded homeownership to a larger market, particularly first-time homebuyers and homebuyers who don't have a lot of money to put down or don't have ideal credit.

During the most recent economic downturn, the GSEs suffered, just like seemingly everybody did. The appetite for more products and looser guidelines so that more borrowers could own homes was a major contributor to creating the bubble that eventually burst in 2007. In 2008, Fannie Mae and Freddie Mac, which owned or guaranteed 50 percent of the $12 trillion mortgage market, were placed into the conservatorship of the Federal Housing Finance Agency (FHFA).

Since the conservatorship, Fannie and Freddie's stocks have been delisted from the New York Stock Exchange, but the GSEs continue to be the primary source of funding for the majority of loans in the U.S. mortgage marketplace. Tougher underwriting rules, loan-overlay requirements and a commitment to loan quality versus loan volume have led to a major turnaround in the GSEs' fortunes in recent years.

Loan programs

With the GSEs being the primary source of funding for U.S. mortgage loans, and with America's wide variety of financing needs and situations, successful lenders must offer a wide variety of government-assisted loans. The large portfolio of GSE products also opens up a greater number of opportunities for partners who specialize in the market segments best served by the GSEs. In addition, the features of GSE products give originators a lot of flexibility in tailoring loan solutions to their clients' needs.

The GSEs require that lenders demonstrate proficiency in the products for which they wish to become direct lenders. For example, in the case of Fannie's HomeStyle Renovation Loan program, lenders must demonstrate that they have a quality-control system in place, a program director with the required experience, and an underwriting supervisor who is qualified in the subject area.

- **Fannie Mae HomeReady Mortgage:** This program provides affordable home financing for low- to moderate-income borrowers, with expanded eligibility for homes in designated low-income, minority and disaster-impacted communities. It features up to 97 percent purchase financing as well as reduced mortgage insurance requirements. A nonborrower household member can be considered in the qualifying debt-to-income ratio.
- **Fannie Mae HomeStyle Renovation Loan:** This loan has one application, one closing and one monthly payment, and it allows borrowers to fund a purchase or refinance mortgage as well as renovation costs, with downpayments as low as 5 percent and refinances of up to 95 percent loan-to-value. Homebuyers can make renovations totaling up to 50 percent of the future as-completed value of their property with a first mortgage rather than a more costly method.
- **Freddie Mac Home Possible and Home Possible Advantage Mortgages:** These loans provide low- to moderate-income borrowers as well as first-time homebuyers with a low-downpayment option, reduced mortgage-insurance requirements and flexible closing-cost funding options. With these products, originators can increase their volume, lower their costs and increase their Community Reinvestment Act-eligible volume.

Underwriting options

Fannie Mae and Freddie Mac have worked to provide reasonably standardized underwriting guidelines so that borrowers, through their lenders, can have some consistent expectations regarding qualifying for mortgage products. Automated innovations like Desktop Underwriter (DU), for underwriting Fannie Mae and FHA mortgages, and Loan Prospector (LP), for underwriting Freddie Mac mortgages, have helped remove much of the subjective decisionmaking regarding credit quality, loan performance, and asset valuation that existed previously.

This month, an updated version of DU, release 10.0, will automate the complicated assessment for borrowers with multiple financed properties. Another change introduced by DU 10.0 will be a new "trended-credit data" approach to assess a borrower's pay history on revolving debts using historical data over the past 24 months.

Also this summer, Freddie Mac will rebrand and re-introduce LP with a new name: Loan Product Advisor. Freddie Mac also will introduce its collateral-review software solution, Loan Collateral Advisor, along with six other tools focused on loan quality or loan delivery.

The GSEs also are seemingly in a race to reassess their underwriting guidelines. In the past few months, loan-to-values have increased on Fannie's high-balance and Freddie's super-conforming loan products, making it easier for borrowers with higher loan amounts to access more financing options. Fannie also has removed its continuity-of-obligation requirements that were cumbersome when working with borrowers looking to refinance their homes.

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The future role of Fannie Mae and Freddie Mac is still the subject of debate, specifically whether they should remain under the control of Congress or be privatized. But there is no question they play an essential role in the mortgage industry today and will continue to do so for the foreseeable future. As the economy continues to gradually improve and the market becomes more sustainable, new risks will be taken, new challenges will present themselves, new products will emerge and new players will enter the lending space. That will be when the mortgage industry really understands and appreciates the vital role played by the GSEs. It is hard to imagine where the industry would be without these key players. ■