Real Estate Newsletter **Volume 2**
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What Would Happen to the Real Estate Market if Fannie Mae and Freddie Mac Ceased to Exist ?

By: Pierre E. Debbas, Esq.

In the second quarter of the year, there was talk of government owned entities, Fannie Mae and Freddie Mac being phased out. Fannie/Freddie purchase or guarantee approximately 90% of all mortgages in the country. These entities are currently trillions of dollars in debt and, according to various reports, have received $138 billion in taxpayers' money.

How would we ever phase Fannie/Freddie out and what are the pros and cons to doing so?

The biggest crutch in the nation's real estate market and the main reason that it is not able to rebound (despite historically low interest rates) is the fact that the stringent lending regulations imposed by Fannie/Freddie are making any chance of a recovery impossible. The government should be focused on ways to incentivize private lending to return to the market and replace the liquidity provided by Fannie/Freddie. This will lead to more efficient lending regulations which banks can determine on their own without the need to abide by those imposed by the government entities. In 2010, the nation's 10 largest mortgage lenders denied 26.8% of all mortgage applications[i]. Several of these applicants were qualified borrowers, but they could not obtain mortgages due to arbitrary restrictions imposed on their credit-worthiness and on the apartment buildings in which several borrowers were looking to purchase (something we are experiencing with the requirements on co-op/condo buildings in Manhattan).

If the banks were not subject to such regulations, they could write their own underwriting regulations stemming from their expertise in the different markets in the country, which would make it easier for qualified borrowers to obtain a mortgage, purchase a home, stabilize prices and make it more practical for private money to reenter the market place. The banks would have to keep a higher percentage of mortgages in their portfolios and provide more adequate information about the mortgages they are selling to private investors. Additionally, this would significantly reduce any risk of subprime lending reoccurring. The reason being is that the banks will not be able to blindly sell their mortgages to Fannie/Freddie without them knowing what they are really buying. The result of such practices leads to Fannie/Freddie trying to force the banks to buy back billions of dollars in mortgages in the middle of a recession.

The negative aspect of relying so heavily on private money to provide liquidity to the market is that interest rates on mortgages will certainly increase significantly. However, we are currently seeing interest rates at all-time lows and in 2010, only 323,000 new homes were sold across the country. This volume is less than 60% of the number of new homes sold in 1963.[ii] The replacement of the government's liquidity into the market will be the biggest obstacle if Fannie/Freddie are ever phased out. Mortgages will not be as profitable for banks due to the fact that they won't be as easy to sell, but the stability in the market will compensate for a reduction in profitability.

Impact of Fannie/Freddie Regulations On Real Estate Transactions

We are experiencing issues in the New York City market due to requirements imposed on co-op/condo buildings which they may not be able to meet. The banks are demanding that buildings increase their fidelity bond insurance, their flood insurance, add line items for a reserve fund in their "projected budgets" for the upcoming year, amongst several other regulations, which in reality, do not lead to added protection for the banks. Is a bank justified for refusing to lend to a building in the middle of New York City due to the fact that they want the building to have $15,000,000 in flood insurance as opposed to the current coverage of $5,000,000 (when the loan to value ratio on the apartment is 66% - this is happening to a deal we are currently working on)? Is the Hudson River

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overflowing into Manhattan and damaging an apartment on the 10th floor of a building a realistic risk for the banks? Shouldn't the government be concerned with buyers who are able to finance 96.5% of their homes (as provided for by the Federal Housing Administration), having little skin in the game and less of an incentive not to throw the keys to the bank if their home value ever goes underwater?

The government's attempts to revitalize the housing market have failed. The first time home buyer tax credit we saw last year did nothing more than shift sales forward and give a rebate to homeowners who would have bought homes anyway[iii]. The reduction in the cost of money to the consumer has not increased activity. The only way for the government to ignite a recovery in the housing market is to reduce its involvement in mortgages, work with the banks in creating general underwriting regulations (i.e. loan to value limitations, debt to income ratios, etc.), come up with ways for banks to forgive portions of outstanding debt and enable the securitization markets to play more of an integral role in the housing market and for the government to play less of a role.

Pierre E. Debbas was quoted in the cover story for the June issue of Habitat Magazine entitled **"Under Scrutiny – Federal Mortgage Guidelines"** which discusses the issues with the government's lending regulations. A copy of the article is attached to this newsletter.

Michael R. Feldman, Esq. Joins the Firm

In the second quarter of 2011, **Michael R. Feldman, Esq.** joined the firm. Michael has been practicing for over three (3) years and specializes in the all aspects of real estate.

Transactions of Interest

We recently represented a purchaser of a $3.9 million townhouse as well as the private bank which financed the acquisition with a $2 million loan secured by the unit. The property was encumbered with an unusual license agreement which needed to be assigned at the closing . This matter was handled by **Pierre E. Debbas, Esq**. and **Michael J. Romer, Esq.**

In the last quarter, Romer Debbas represented the purchaser of a $4 million co-op unit. As condition of board approval, the purchaser was obligated to renovate and upgrade the electrical systems pertaining to the unit. This became evident a mere 1-2 weeks before the closing. on short notice, we were able to successfully negotiate a fair and reasonable agreement which all sides were comfortable with. This matter was handled by **Pierre E. Debbas, Esq.** and **Michael J. Romer, Esq.**

Romer Debbas recently represented a foreign investor from Singapore who purchased a $2,000,000.00 condominium on the east side of Manhattan. In order to pull off the deal, we needed to first structure an entity to suit our client's specific needs and unique situation. The end result was a newly formed New York limited liability company with a British Virgin Islands corporation as its controlling member. We were then able to locate an understanding lender willing to finance our client's acquisition. The transaction successfully closed in June 2011. This matter was handled by **Pierre E. Debbas, Esq.**

We recently represented a prominent private bank in connection with a multi-part transaction for the same customer. The private bank extended three custom loans totaling in excess of $4 million to the same client. Each loan was secured by a separate property. All three loans closed on the same day upon a mere 48 hours notice to accommodate the client's schedule. This matter was handled by **Michael J. Romer, Esq.**

Romer Debbas recently represented a foreign investor from Chile who was purchasing a co-op unit in Manhattan. As part of this transaction, the firm guided the purchaser through an arduous board application process which, after much negotiation, resulted in the purchaser being approved subject to his depositing one year's worth of maintenance in an escrow account to be held for the duration of his ownership. This transaction is an example of the obstacles a foreign buyer of a co-op can face. This matter was handled by **Michael J. Romer, Esq.** and **Michael R. Feldman, Esq.**

LLP. This newsletter should not be used to replace the advice of an attorney.

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[i] Nick Timiraos and Maurice Tamman Tighter Lending Crimps Housing, June 25, 2011 The Wall Street Journal
[ii] Kelly Evans The Housing Headache Felt All Over, May 24, 2011 The Wall Street Journal
[iii] Nick Timiraos Why the Housing Tax Credit Failed, July 12, 2011, The Wall Street Journal