Doron F. Eghbali Residential Real Estate Law

Fannie Mae Makes It Harder to Obtain Adjustable and Interest Only Residential Loans

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Fannie Mae starting from September 2010 implements stricter criteria to give adjustable and interest only loans to residential borrowers in hopes to prevent another housing bubble that wreaked havoc on the US economy as a whole. Freddie Mac had already tightened its borrowing criteria for such mortgages.

SOME BACKGROUND

1. Adjustable Rate Mortgages

For years, during the housing boom, borrowers purchased homes they cold hardly afford using adjustable rate mortgages. Such loans had initial low rates and home buyers hoped by the time payments rose the value of their homes would rise accordingly and they could either sell or refinance. However, as prices stopped rising and even started precipitously plummeting, home buyers could neither sell nor refinance. As a result, home defaults soared.

2. Interest-Only Mortgages

Interest-only mortgages allow borrowers to defer principal payments on the loan for the first 5 to 10 years. However, again, home borrowers had banked on the incessant rise in their home prices and the availability of an able buyer or bank to purchase or refinance their house. However, this line of reasoning also proved short-sighted and avaricious and home defaults soared.

3. Impact of Housing Bust on Fannie Mae and Freddie Mac

Fannie and Freddi are semi-governmental entities that guaranty most of home loans in the US. As such, as the defaults rose, Fannie and Freddie had to take losses and this appreciably diminished their capital reserves and put them on the brink of bankruptcy. To avert a seemingly-devastating financial disaster, the government in September of 2008 placed Fannie Mae and Freddie Mac in conservatorship. The government has so far injected more than $126 billion of taxpayers money into these entities to keep them afloat.This number will likely grow.

SOME OF THE SPECIFICS OF FANNIE MAE NEW STANDARDS

In light of what Fannie and Freddie experienced, this seems logical to tighten their belt and dole out loan more prudently. Here are some of the guidelines Fannie Mae will abide by in September for interest only and adjustable rate mortgage applicants.

- **Relatively High Credit Score:** The Applicants MUST have at least a 720 credit score.
- **Relatively High Equity in the House:** The Applicants MUST have at least 30% equity in the house.
- **Relatively High Cash Reserves:** The Applicants MUST also have at least two years of cash reserves after closing.
- **Relatively High Interest Rates for Adjustable Rate Mortgages Reset in the First Five Years:** The Applicants whose adjustable rate is reset within the first five years MUST pay relatively higher rates. In fact, lenders MUST qualify such applicants under higher payment levels: EITHER the current interest rate PLUS two percentage points OR the current interest PLUS the extra margin charged by the lender.

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