

Lifting Fannie, Freddie Mortgage Limits Could Help Investors Most

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Raising value limits on conforming loans could do more to lift bond market confidence than to broadly help refinancers and home buyers.

Mortgage lenders and housing analysts are hailing a new law President Bush signed Wednesday that raises the cap on loans Fannie Mae (NYSE:FNM) FNM and Freddie Mac (NYSE:FRE) FRE can buy. They say it will bring a critical injection of confidence into an illiquid mortgage bond market. But they're skeptical it will make much dent in the housing slump by spurring sales and cutting foreclosures.

Analysts say many jumbo borrowers, especially those whose adjustable rate mortgages need refinancing, won't be able to meet the loan standards Fannie and Freddie have, though their mortgage amounts could now qualify as conforming loans vs. nonconforming jumbos.

The new loan caps, part of the \$152 billion government economic stimulus package, will let the GSEs -- government-sponsored enterprises Fannie and Freddie -- buy loans up to \$729,750 the rest of the year, far beyond the old \$417,000 conforming limit. New limits vary by area and home type, maxing out at 125% of the local median price.

"Raising the limit will open the refinancing door for a segment of homeowners that have been left out in the cold," said Greg McBride, senior financial analyst with rate watcher Bankrate.com.

Show 'Em The Money

Borrowers will need good credit, proof of income, and sufficient home equity or more cash down to qualify for the loans, he says.

"If you're lacking in any of those three, that's a big hurdle to getting a deal done," McBride said.

Mortgages are tougher to get now compared with much of this decade. Gone are the days when borrowers could buy a house using 100% debt. Often those deals meant getting one mortgage for 80% of the price and a 20% piggy-back loan.

Lenders of all stripes want borrowers to put money down when buying a home and to possess a good chunk of equity when refinancing, McBride says. How much cash or equity required depends on the local housing market the home's in.

Lately, lenders have been demanding more money down in markets where home values are on the decline. If they required 5% down before, they might require 10% today. Fannie Mae set a new rule in January: Whatever the maximum loan-to-value ratio permitted, it must be reduced by five percentage points if the home's in a declining market.

Raising the level of down payment required helps cut risk that borrowers will owe more than the home's worth if values keep falling. The bottom line: The bigger the down payment or equity, the better terms a borrower will get, McBride says.

"You have to bring something to the table other than the pen to sign the paperwork," he said. "Lenders want borrowers to have some skin in the game."

Many jumbo loan borrowers aiming to refinance could have problems meeting stringent Fannie and Freddie rules, because they didn't have to meet conventional loan requirements over the last decade, says Michael Covino, president of Luxmac Covino & Co., a Tarrytown, N.Y., home lender originating \$500,000 to \$40 million loans.

Jumbo loan borrowers frequently take out Alt-A mortgages, a product introduced in the 1990s for small-business owners whose income patterns differed from typical borrowers. Generally, Alt-A loans let borrowers provide less proof of income or simply state their income. Lenders typically view Alt-A as less risky than subprime, but not as safe as prime borrowers who typically provide more complete information.

Covino predicts jumbo refinancers will have a tough time proving their housing debt bills don't top 38% of their total income. "They never did meet that ratio," he said.

In recent years bond buyers confidently bought up securities backed by jumbos, acquiring \$451 billion of the loans in 2005, \$378 billion in 2006 and \$160 billion midway through 2007, says the Office of Federal Housing Enterprise Oversight.

Last summer the housing slump, rising subprime defaults and falling home values scared bond buyers from residential paper not backed by Fannie or Freddie. That made it hard for jumbo lenders to bundle and sell loans and fund mortgages.

Can Jumbos Fly?

Lenders expect that raising Fannie and Freddie caps will bring back bond buyers and mean better terms for high-end borrowers who meet GSE underwriting standards.

"Of the entire stimulus package, this is the thing that's going to help the most," Covino said. "It's the only way to create liquidity for jumbo paper."

The climate around conforming loans has been sunnier. "From what we've seen in the secondary market there's still a healthy demand for loans that conform to Fannie Mae and Freddie Mac existing guidelines," said real estate investment trust Thornburg Mortgage (NYSE:TMA) TMA in an e-mailed statement. It originates jumbos and sells the paper on secondary markets.