

**December 5, 2007**  
**Announcement 07-22:**  
***Maximum Financing in Declining Markets***

**Summary and Frequently Asked Questions (FAQs)**

**Summary**

Announcement 07-22 reinstates a policy to restrict the maximum loan-to-value (LTV) ratio and combined loan-to-value (CLTV) ratio for properties located within a declining market to five percentage points less than the maximum permitted for the selected mortgage product. Also, Fannie Mae strongly encourages lenders to use supplemental sources and tools to independently assess current housing trends to help the lender determine whether appraisals accurately reflect market conditions.

For mortgage loans underwritten through Desktop Underwriter<sup>®</sup> (DU<sup>®</sup>), DU generates a message on loan casefiles when it appears that the property is located in an area identified as declining, or in a market in which it is difficult to assess home values. When the lender receives this message, the LTV for the mortgage loan must be adjusted to five percentage points below the maximum for the specific mortgage product unless the lender has evidence in the origination file that the property is not located in a declining market.

For mortgage loans that are not underwritten with the assistance of DU, lenders must take appropriate steps to independently assess market conditions to determine if the appraisal accurately reflects current market conditions and value.

The only circumstance in which the application of the maximum financing in a declining market policy will not apply is when the borrower has an existing Fannie Mae–owned or -securitized first mortgage and is requesting a new limited cash-out refinance mortgage. The policy also does not apply to reverse mortgage loans.

**FAQs**

**Q1. The announcement mentions that this is a “reinstatement” of the policy – when was this policy previously in effect?**

This policy was in the Fannie Mae *Selling Guide* until it was removed nearly two years ago, in January 2006.

**Q2. When will the new policy be effective?**

The policy is effective for all loans delivered to Fannie Mae with an **application date** on or after January 15, 2008.

**Q3. How long will this policy remain in effect?**

It should be considered a long-term policy that will apply to delivery of loans to Fannie Mae regardless of current market conditions or the rate of decline in home values.

**Q4. What is an example of a situation in which the lender could have evidence that the property is not in a declining market, and what documentation would be required?**

Declining markets typically are identified at the ZIP code, metropolitan area level, or census tract, and Fannie Mae recognizes that there may be pockets of stability within declining markets.

For example, a loan casefile is submitted to DU for 95 percent financing, but DU provides a message that the property is located in a declining market. The appraisal report indicates, however, that the property is in a stable neighborhood where prices are holding steady. The lender carefully reviews the appraisal report to ensure that it includes recent comparable sales supporting the conclusion that home prices are not declining in the neighborhood. The lender also has in place its own process to independently assess market conditions, which indicates that the appraisal accurately reflects current market conditions and value. The lender may provide 95 percent financing and must retain documentation of its analytical process and tools.

**Q5. How does Fannie Mae define a declining market?**

There is no standard definition of a declining market. In general terms, Fannie Mae defines a declining market as one in which home prices are currently declining, as determined by the tracking of home prices in a certain geographic location (state, Metropolitan Statistical Area, ZIP code, census tract, etc.). Organizations or services that track declining markets may each use different approaches and databases to make their determination.

**Q6. Does Fannie Mae recommend a particular tool to help lenders monitor declining markets?**

The Announcement provides several third-party sources that track this information, which are just a few of the many resources available to lenders. Also, many lenders have developed their own database and analytical tools for identifying declining markets. If a lender provides its own tracking tool or decides to use one of the third-party services, the lender is responsible for deciding which tool or service it believes provides the information it needs to determine that the appraisal accurately reflects market conditions.

**Q7. Isn't it primarily the appraiser's responsibility to determine whether a property is located in a declining market?**

Both the lender and appraiser ultimately are responsible for determining whether a property is located within a declining market. The appraiser may indicate this in the neighborhood section of the appraisal report, and/or the lender may make an independent decision based on its tracking of home prices in a certain area. We expect the lender to address any discrepancies between the information reflected in the appraisal report and the results of the lender's own due diligence by requesting additional information and justification from the appraiser.

**Q8. Does Fannie Mae require a Special Feature Code at delivery to identify a mortgage loan secured by a property located in a declining market?**

No special feature code is required for delivery of a mortgage loan secured by a property determined to be located in a declining market (regardless of whether or not the maximum financing policy has been applied to the loan).

**Q9. What are some examples of situations in which the maximum financing policy would be applied?**

Here are several examples:

- A loan casefile is submitted to DU for 100 percent financing with a Flexible 100™ mortgage, but DU provides a message that the property is located in a declining market. The maximum financing would be limited to 95 percent unless the lender has evidence that the property is not in a declining market. If the lender reduces the borrower's LTV, the lender is advised to resubmit the loan casefile to DU with the new LTV. If the borrower uses flexible sources of funds to make the 5 percent down payment, the loan would still be considered a Flexible mortgage. If not, the loan would become a standard mortgage loan (at 95% LTV).
- A loan is submitted to a lender's automated underwriting system for 95 percent financing with a standard 30-year fixed-rate loan. The appraisal report does not indicate that the property is in a declining market. Nevertheless, the lender's own process indicates that the property is located in a declining market. The maximum financing amount must be 90 percent unless the lender can document that the property is not located in a declining market.
- A loan casefile is submitted to DU for 95 percent financing with a 3/1 fixed-period ARM (not eligible as a Flexible mortgage). DU does not indicate that the property is located in a declining market. The appraisal report, however, states that home prices in the neighborhood are declining. The maximum financing amount would be 90 percent. Once the lender has reduced the borrower's LTV, the lender is advised to resubmit the loan casefile to DU with the new LTV.
- A loan casefile is submitted to DU for 97 percent financing with MyCommunityMortgage® (MCM®), but DU provides a message that the property is located in a declining market. The maximum financing would be limited to 95 percent (5 percentage points below the product maximum of 100 percent) unless the lender has evidence that the property is not in a declining market. Once the lender has reduced the borrower's LTV, the lender is advised to resubmit the loan casefile to DU with the new LTV.

**Q10. If a lender submits a loan casefile to DU for 95 percent financing, and receives the declining markets message, must the LTV be reduced to 90 percent?**

If the loan casefile **would not** be eligible under Flexible mortgage guidelines, the maximum financing of 95 percent would be reduced to 90 percent in a declining market. If the loan casefile **would be** eligible under Flexible mortgage guidelines, the maximum financing of 100 percent would be reduced to 95 percent in a declining market. (Refer to the [Flexible mortgage matrix](#) for eligibility details.)

**Q11. Why is a lender advised to resubmit a loan casefile to DU after adjusting the LTV downward by 5 percentage points?**

The lender is advised to resubmit the loan casefile to DU to ensure that accurate messaging is provided, including the level of mortgage insurance coverage required. Also, for loans underwritten with the assistance of DU, resubmitting the loan casefile will ensure that when the loan is delivered to Fannie Mae, the loan data matches the data for the loan casefile in DU. When a loan casefile is resubmitted, the lender should disregard the declining market message if the LTV adjustment has already been made, even if the

resubmission changes the mortgage product (for example, the loan goes from a Flexible mortgage to a standard mortgage loan).

**Q12. How is this policy applied to a loan with subordinate financing?**

When subordinate financing is being used, maximum financing is being requested, and the property is identified as being located in a declining market, the CLTV must be adjusted. For example, if a Flexible 80/20 mortgage is proposed, the CLTV must be adjusted to 95 percent, so the loan could instead be, for example, an 80/15 or 75/20.

**Q13. Are there any Fannie Mae loan products that are exempt from the 5 percentage point reduction?**

Reverse mortgage products are exempt.

**Q14. How will Fannie Mae monitor compliance with the maximum financing in declining markets policy?**

Financing that exceeds the value of a property is a serious risk for Fannie Mae as an investor. To prudently manage our risk, we are taking steps as part of our normal quality control process to conduct post-acquisition reviews of a sample of loans delivered to us to ensure that financing for loans secured by properties located in declining markets does not exceed the reduced maximum for the mortgage product used.