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Fannie Mae Seeks to Ease Mortgage Rules

By Myriam Denis, J.D. Candidate 2016 | November 24, 2014

Despite current low interest rates, the U.S. housing market is still struggling and is not back to the pre-2008 crisis status. The federal government wishes to increase available housing credit to bring more people into the housing market by expanding mortgage availability with lower down payments. These changes could set the stage for more lending.

Fannie Mae, the largest government-backed mortgage entity and the leading source of private residential mortgage credit in the U.S., recently detailed how the program would operate. Timothy J. Mayopoulos, Fannie Mae CEO, said he expected Fannie's low-down-payment mortgages to cost the borrower less than similar loans available under other government programs. But he also warned that Fannie's loans would require private mortgage insurance on top of the down payment.

Since 2008, about 80 percent of mortgages have some kind of taxpayer guarantee, usually in the form of private bond investors backed by the government, like Fannie Mae. Currently, these companies only guarantee mortgage amounts equivalent to roughly 80 percent of the property value, meaning borrowers need to make a down payment of about 20 percent. Melvin L. Watt, director of the Federal Housing Finance Agency, said last month that he wanted Fannie Mae and other companies to back loans with down payments as low as 3 percent of the house value. Other measures include a relaxation of the terms under which the government can make banks take back soured mortgages.

Because Fannie Mae's charter prevents it from backing loans exceeding 80 percent of the house value, private mortgage insurance making up for the portion of the 20 percent not covered with a down payment is needed in order for lower down payments to be approved.

But do private mortgage insurers want to take on this business? How far can regulations go in broadening credit access? Some analysts are concerned that the program could lead to higher defaults. Lower down payments mean the insurer takes a higher risk if the borrower defaults. Many studies show that borrowers who make down payments of 20 percent or more usually have lower default rates, and, the lower the down payment, the riskier the lending. Mark A. Calabria, director of financial regulation studies at the Cato Institute and former senior professional staff of the U.S. Senate Committee on Banking, Housing and Urban Affairs, a libertarian-leaning research group said, "you can make low-down-payment loans to people with high credit and high-down-payment loans to people with low credit. It's when you mix the two that you start to see skyrocketing default rates."

Recent reports from the U.S. Department of Housing and Urban Development show that the average credit score of loans backed by the Federal Housing Administration is about a 680 FICO, meaning half of these loans are subprime. In response to those numbers, Calabria said in a

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recent blog post, "Lenders should be held responsible for making loans of such poor credit quality."

Mayopoulos replied to those concerns by countering that private mortgage insurers have capital to put to work and are expressing an interest in taking on this business.

How successful will these proposals be? Are these kinds of measures what the housing market needs to go back to pre-2008 levels? Only time will tell.