FannieMae
3900 Wisconsin Avenue, NW
Washington, DC 20016-2892

Announcement 08-16 ***June 25, 2008***

Amends these Guides: Selling

Bankruptcy, Foreclosure, and Conversion of Principal Residence Policy Changes; and Revised Property Value Representation and Warranty Requirements

Introduction

With this Announcement, Fannie Mae is introducing several new and updated policies that pertain to the following topics:

- **Bankruptcy and foreclosure policies**: updates to manual underwriting requirements for borrowers with prior bankruptcy or foreclosure actions in their credit history, including deeds-in-lieu of foreclosure and preforeclosure sales,
- **Conversion of principal residence to second home or investment property**: new requirements for borrowers who are purchasing a new principal residence, and intend to convert their existing principal residence to a second home or investment property, and
- **Representation and warranty requirements**: revised property value representation and warranty requirements for mortgage loans that are closed more than 6 months up to 12 months prior to the date the loan is sold to Fannie Mae.

The effective dates for each of the above updates are outlined at the end of this Announcement.

Bankruptcy and Foreclosure Policy Changes

***Selling Guide*, Part X, Section 302.10, Prior Bankruptcy or Foreclosure; and Section 803.02, Payment History**

Announcement 08-08, *Mortgage Eligibility and Pricing Updates for Desktop Underwriter® and Manually Underwritten Loans*, dated March 31, 2008, outlined changes to the requirements for borrowers with a prior foreclosure in their credit history. With this Announcement 08-16, Fannie Mae is updating the requirements regarding the time period that must elapse before borrowers can demonstrate they have reestablished their credit history after the occurrence of a bankruptcy or foreclosure. The updates pertain to the following policies.

Updating the requirements for bankruptcy actions to apply from the discharge or dismissal date, whichever is applicable, and requiring a longer elapsed time period for Chapter 13 bankruptcies that were dismissed. For all bankruptcy actions, the elapsed time period to reestablish credit will now be measured from the bankruptcy discharge or dismissal date. For all bankruptcy cases, other than Chapter 13 cases, the time period to reestablish credit remains at 4 years. For Chapter 13 cases, a distinction is being made between Chapter 13 bankruptcies that were discharged and those that were dismissed. The updated policy recognizes the fact that borrowers have reestablished credit through the successful completion of a Chapter 13 plan and subsequent discharge by requiring only a 2-year time period to elapse. A borrower who was unable to complete the Chapter 13 plan and received a dismissal, however, will be held to a 4-year time period for reestablishing credit.

Establishing a new policy for borrowers who have more than one bankruptcy filing in the past 7-year time period. A 5-year elapsed time period is now required to reestablish credit from the most recent discharge or dismissal date for borrowers who have more than one bankruptcy filing in the past 7 years. The presence of multiple bankruptcies in the borrower’s credit history is evidence of significant derogatory credit and increases the likelihood of future default. The greater the number of such incidences and the more recently they occurred, the higher the credit risk.

Establishing a new policy for preforeclosure sales. A preforeclosure sale involves the sale of the property by the borrower to a third party for less than the amount owed to satisfy the delinquent mortgage, as agreed to by the lender, investor, and mortgage insurer. Due to the increased incidence of preforeclosure sales, Fannie Mae is establishing a 2-year elapsed time period for reestablishing credit following completion of the action.

The following table outlines Fannie Mae’s current and new policies for manually underwritten loans related to the time period that must elapse before borrowers can demonstrate they have reestablished an acceptable credit history after the occurrence of the bankruptcy or foreclosure. The table also includes new "Additional requirements" that apply to foreclosures.

Action	Current Requirements	New Requirements
Bankruptcy (All Except Chapter 13)	4-year time period from discharge date	The 4-year time period remains the same but will now be applied from either the discharge or dismissal date of the bankruptcy action.
Chapter 13 Bankruptcy	2-year time period from discharge date	The time period for Chapter 13 bankruptcy actions is measured as follows: • 2 years from the discharge date, or • 4 years from the dismissal date.
Exceptions for Extenuating Circumstances – All Bankruptcy Actions	2-year time period from discharge date. No exception to the 2 year time period for Chapter 13 bankruptcy actions.	The 2-year time period will be measured from the bankruptcy discharge or dismissal date. No exceptions are permitted to the 2-year time period after a Chapter 13 discharge.
Multiple Bankruptcy Filings	No existing policy	5-year time period from most recent dismissal or discharge date required for borrowers with more than one bankruptcy filing within the past 7 years.
Exceptions for Extenuating Circumstances – Multiple Bankruptcy Filings	No existing policy	3-year time period from the most recent discharge or dismissal date **Note**: The most recent bankruptcy filing must have been the result of extenuating circumstances.
Foreclosure[1]	4-year time period from the date the foreclosure sale was completed ("completion date")	5-year time period from completion date Additional requirements that apply after 5 years up to 7 years following completion date: • The purchase of a principal residence is permitted with a minimum 10 percent down payment and minimum representative credit score of 680. • Purchase of a second home or investment property is not

[1] The "New Requirements" were previously announced in Announcement 08-08, but additional clarification is provided here.

Action	Current Requirements	New Requirements
		permitted. • Limited cash-out refinances are permitted for all occupancy types pursuant to the eligibility requirements in effect at that time. • Cash-out refinances are not permitted for any occupancy type.
Exceptions for Extenuating Circumstances – Foreclosure[1]	2-year time period from completion date	3-year time period from completion date Additional requirements that apply after 3 years up to 7 years following completion date: The same additional requirements apply as above except the minimum credit score of 680 is not required.
Deed-in-Lieu of Foreclosure	4-year time period from completion date (date deed-in-lieu executed)	No change Additional requirements that apply after 4 years up to 7 years following completion date: • Borrower may purchase a property secured by a principal residence, second home, or investment property with the greater of 10 percent minimum down payment or the minimum down payment required for the transaction. • Limited-cash-out and cash-out refinance transactions secured by a principal residence, second home, or investment property are permitted pursuant to the eligibility requirements in effect at that time.
Exceptions for Extenuating Circumstances – Deed-in-Lieu of Foreclosure	2-year time period from completion date	No change The same additional requirements noted above for deed-in-lieu apply after 2 years up to 7 years following completion date.

Action	Current Requirements	New Requirements
Time Period After Preforeclosure Sale	No existing policy	2-year time period from completion date. Additional Requirements: None **Note**: No exceptions are permitted to the 2-year time period due to extenuating circumstances.

Note: The *Selling Guide*, Part X, Section 803.02 contains several requirements the lender must follow in order to determine that the borrower has successfully reestablished his or her credit history after a bankruptcy or foreclosure action. These requirements continue to be applicable, in addition to the elapsed time periods and any additional requirements noted above. Additionally, Desktop Underwriter (DU®) will be updated in a future release to incorporate some or all of the policy changes noted above.

Conversion of Principal Residence to Second Home or Investment Property

***Selling Guide*, Part X, Section 402.24 Rental Income, and Section 702.03 All Other Liabilities, D. Payments on real estate mortgages**

Borrowers who currently own their home typically have three options when they decide to purchase a new principal residence. They can

- sell the current residence and pay off the outstanding mortgage,
- convert the property to a second home, assuming they can qualify with both the existing and new mortgage payments, or
- convert the property to an investment property and provide documentation that they will rent the property and use the income to offset the mortgage payment.

In order to ensure that borrowers have sufficient equity and/or reserves to support both the existing financing and the new mortgage being originated, Fannie Mae is updating the policies for qualifying borrowers purchasing a new principal residence and converting their existing principal residence to a second home or investment property.

Current Requirements
• Rental income that will be generated from the prior principal residence is based solely on a fully executed lease agreement for that property provided by the borrower (now landlord). • If the lender uses current lease agreements, the net rental income will be 75 percent of the gross rent from the lease agreement, with the remaining 25 percent being absorbed by vacancy losses and ongoing maintenance expenses. • Minimum reserves are required for investment properties: 2 months for one-unit properties, and 6 months reserves for two- to four-unit properties. Minimum reserves are not required for second home transactions.

<table>
<tr><th colspan="2">New Requirements</th></tr>
<tr><td>Current principal residence is pending sale but the transaction will not be closed (with title transfer to a new owner) prior to the new transaction</td><td>Both the current and the proposed mortgage payments must be used to qualify the borrower for the new transaction.</td></tr>
<tr><td>Conversion to a Second Home</td><td>Both the current and the proposed mortgage payments must be used to qualify the borrower for the new transaction; and
6 months of PITI for <u>both</u> properties is required to be in reserves. Lender may consider reduced reserves of no less than 2 months for both properties if there is documented equity of at least 30 percent in the existing property (derived from an appraisal, automated valuation model (AVM), or Broker Price Opinion (BPO), minus outstanding liens)</td></tr>
<tr><td>Conversion to an Investment Property</td><td>Fannie Mae will continue to permit up to 75 percent of the rental income to be used to offset the mortgage payment in qualifying if there is documented equity of at least 30 percent in the existing property (derived from an appraisal, AVM, or BPO, minus outstanding liens).

The rental income must be documented with:
a copy of the fully executed lease agreement; and
the receipt of a security deposit from the tenant and deposit into the borrower's account.
If the 30 percent equity in the property cannot be documented, rental income may not be used to offset the mortgage payment.
Both the current and the proposed mortgage payments must be used to qualify the borrower for the new transaction; and
6 months of PITI for <u>both</u> properties is required to be in reserves.</td></tr>
</table>

These guidelines are applicable to manually underwritten loans and, except for the additional reserve requirements, must also be applied (on a manual basis) to loan casefiles underwritten with DU. DU will determine the level of reserves for each loan casefile.

Revised Property Value Representation and Warranty

***Selling Guide*, Part 1, Section 202.01 Additional Selling Warranties, C. Product-specific warranties**

Fannie Mae has conducted a review of the standard *Selling Guide* representations and warranties applicable to the value of the subject property. Under Fannie Mae's existing requirements, lenders must represent and warrant that the current value of a property is not less than the original property value for loans that are closed more than 12 months prior to the date the loan is sold to Fannie Mae. With this Announcement, Fannie Mae is expanding the coverage of the existing representation and warranty related to property value to now include mortgage loans that are closed more than 6 months up to 12 months prior to the date the loan is sold to Fannie Mae. In addition, if the lender is unable to provide the new representation and warranty, Fannie Mae is specifying the method by which the loans must be delivered.

The following table describes the required property value representation and warranty requirements.

Age from Loan Closing Date to Sale Date	**Required Representation and Warranty**
More than 6 months and up to and including 12 months	Lender must warrant that the current value of the property is not less than the original value.
More than 12 months	The lender must continue to provide the representations and warranties outlined in the *Selling Guide,* Part I, Section 202.01.C, Additional Selling Warranties and Part VII, Section 104.02 Mortgage Seasoning.

Note: For all mortgages, the lender makes the standard Selling Guide warranties related to the original appraisal obtained in connection with the origination of the mortgage, including the accuracy of the appraised value, and its assessment of the marketability of the security property. Fannie Mae is not making any changes to the requirements for the age of the appraisal (the interval between the date of the appraisal and the loan closing date) as outlined in the *Selling Guide*, Part XI, Section 201, Age of Appraisal (or Property Inspection).

Required Delivery Method if Lender is Unable to Provide Value Warranty

For loans that are aged more than 6 months from the closing date to the date the loan is sold to Fannie Mae, if the lender is unable to warrant that the current value of the property is not less than the original value of the property, the loan is not eligible for delivery to Fannie Mae by the lender as flow business. In these instances, the loan must be submitted for delivery as part of a bulk transaction. Bulk transactions will be subject to additional review by Fannie Mae to ensure the loan is eligible for sale, including compliance with maximum loan-to-value ratios and mortgage insurance requirements, and to ensure that the loan is appropriately priced.

Regardless of delivery method, lenders continue to be responsible for standard *Selling Guide* warranties related to the original appraisal, including accuracy of the appraisal and marketability of the property at time of loan origination. For purposes of determining lenders' compliance with these warranties, Fannie Mae may take such steps as it deems appropriate to validate the origination value, including the use of a retrospective property appraisal.

Effective Dates

The changes in this Announcement are effective as follows:

Topic	**Effective Date**
Bankruptcy and foreclosure policies	Loan applications dated on or after August 1, 2008
Conversion of principal residence policies	Loan applications dated on or after August 1, 2008
Revised property value representation and warranty (and delivery requirements)	Whole loans purchased or MBS pools with issue dates on or after August 1, 2008

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Lenders should contact their customer account manager if they have questions about Announcement 08-16.

Michael A. Quinn
Senior Vice President
Single-Family Risk Officer