Announcement 07-23
December 5, 2007

Amends these Guides: Selling

Clarification of Purchase and Refinance Transaction Policies; Modification of Interested Party Contribution Policy

Fannie Mae has received requests for clarification and updates to some of our standard policies to better align with industry standards, and to provide additional information to assist our customers in understanding and applying our policies. In response, we are making the following updates to our Selling Guide:

- **Definitions of Purchase and Refinance Transactions.** We are providing additional clarity to our existing definitions and the aspects of a transaction that determine whether it is considered a purchase, limited cash-out refinance, or cash-out refinance.

- **Interested Party Contributions.** We are announcing several clarifications to our existing guidelines, as well as providing document review guidelines to identify potential issues.

The updates and clarifications discussed in this Announcement are effective immediately and apply to all loans including those underwritten through Desktop Underwriter® (DU®).

Definition of Purchase and Refinance Transactions

In the Selling Guide Part VII, Mortgage Eligibility, Chapter 1, Conventional Mortgages, Section 103 Eligible Transaction Types, the requirements for determining whether a transaction qualifies as a purchase money transaction, limited cash-out refinance transaction or a cash-out refinance transaction are stated.

We are adding the following new standard to the requirements for purchase money transactions set forth in Section 103.01 Purchase Money Transactions:
• The borrower(s) may not receive any cash back through a purchase money transaction, other than an amount representing (a) a reimbursement for the borrower’s overpayment of fees; (b) costs paid by the borrower in advance (e.g. earnest money deposit, appraisal, and credit report fees); or (c) a legitimate pro-rated real estate tax credit in locales where real estate taxes are paid in arrears. If the borrower receives cash back for a permissible purpose listed in the prior sentence, the lender must confirm that the minimum borrower contribution requirement associated with the selected mortgage product, if any, has been met.

In addition, the following clarification is being made for both limited cash-out refinance transactions in Part VII, Section 103.02 Limited Cash-Out Refinance Transactions and cash-out refinance transactions in Section 103.03 Cash-Out Refinance Transactions:

• For a refinance transaction (either limited cash-out or cash-out) to be eligible for sale to Fannie Mae, there must be a continuity of obligation if there is currently an outstanding lien that will be satisfied through the refinance transaction, i.e. there must be at least one borrower obligated on the new loan who was also a borrower obligated on the existing loan that is being refinanced. If there is no continuity of obligation, i.e. if no borrower on the outstanding loan that will be satisfied through the new loan is also a borrower on the new loan; the transaction must be treated as a purchase. If there is not currently an outstanding lien on the subject property, a loan to the property owner secured by the property will be considered a cash-out refinance in accordance with Section 103.03.

Interested Party Contributions

Interested party contributions (IPCs) are costs that are normally the responsibility of the property purchaser that are paid (directly or indirectly) by someone else who has a financial interest in, or can influence the terms and the sale or transfer of, the subject property. These persons or entities include, but are not limited to, the property seller, the builder/developer, and the real estate agent or broker (or an affiliate who may benefit from the sale of the property and/or the sale of the property at the highest price possible).

IPCs provide an incentive for a borrower to purchase a particular property, and in certain real estate markets, IPCs may be used to artificially inflate or maintain the sales price of a property. Fannie Mae has established definitive terms for what constitutes an IPC, specific limits on the use and permissible amounts of IPCs, and how IPCs in excess of permissible limits must be treated. These guidelines are designed to help avoid practices that may distort or artificially inflate the market value of properties.

We are making the following clarifications and changes to our IPC policy:

• **Types of IPCs.** Clarifying the differences between IPCs that Fannie Mae categorizes as financing concessions and sales concessions;

• **Calculation of IPCs.** Reiterating our policy and limits based on occupancy and combined loan-to-value ratio;
• **Allowable Uses of IPCs.** Updating our policy to reiterate that funds that flow from an interested party to a nonprofit and then to the buyer may not be used for downpayment. In addition, these funds must be included in the IPC calculation, and, if applicable, entered appropriately in DU, to determine if the amount of IPC is within our limits;

• **Appraisal Review for Transactions with IPCs.** Reminding lenders that the appraiser must be provided with the sales contract and other information concerning all IPCs for the subject property and related appraisal requirements; and

• **Document Review Guidance.** Identifying documents and areas of concern regarding IPCs.

Details of these updates are provided below, and will amend Part X, Section 602, Contributions by Interested Parties in the Selling Guide.

### Types of IPCs

IPCs are either a financing concession or a sales concession. A financing concession is a financial contribution from an interested party and provides a benefit to the borrowers in the financing transaction. Financing concessions, described below, that are paid on the borrower’s behalf are subject to our IPC limits. Fees and/or closing costs that are typically paid by a seller in accordance with local custom (known as common and customary fees or costs) are not subject to these limits. Financing concessions in excess of our stated limits (see next section) are considered sales concessions. Sales concessions may also include contributions provided by an interested party that benefit the borrower but are not integral to the financing transaction. All sales concessions must be deducted from the sales price when calculating loan-to-value (LTV) and combined loan-to-value (CLTV) ratios for underwriting and eligibility purposes.

#### Financing Concessions

IPCs that are payments or credits related to acquiring the property or paying for financing terms including prepaids are considered financing concessions. Financing concessions in excess of our stated limits (see next section) are considered sales concessions. Financing concessions include, but are not limited to:

- origination fees;
- discount points;
- commitment fees;
- appraisal costs;
- transfer taxes;
- stamps;
- attorneys’ fees;
- survey charges;
- title insurance premiums or charges;
- real estate tax service fees;
- funds to subsidize a temporary or permanent interest rate buydown; and
- prepaid items such as:
- interest charges (limited to no more than 30 days of interest);
- real estate taxes covering any period after the settlement date (only if the taxes are being impounded by the servicer for future payment);
- hazard insurance premiums (limited to no more than 14 months); and
- initial and/or renewal mortgage insurance premiums and any escrow accruals required for renewal of borrower-purchased mortgage insurance coverage.

If a temporary or permanent interest rate buydown is being offered to the borrower then the cost of the subsidy to fund that buydown must be included in the IPC calculation. If the buydown subsidy was included in a standby commitment taken out by the originating lender then the buydown subsidy must be included in the IPC calculation. This can be accomplished by confirming the current market interest rate (those that are offered without the payment of any discount points) and the discount points being charged to obtain the interest rate being offered with the buydown. **Note:** Fees for standby commitments that a builder obtains for blanket coverage before it enters into a contract with a borrower are not subject to our contribution limits because they are not attributable to the specific mortgage transaction.

**Sales Concessions:** IPCs that take the form of non-realty items such as cash, furniture, automobiles, decorator allowances, moving costs, or other “giveaways” are considered sales concessions.

The value of sales concessions must be deducted from the sales price when calculating the LTV and CLTV ratios for underwriting and eligibility purposes.

**Payment Abatements**

Mortgage loans with payment abatements of any type are not eligible for delivery to Fannie Mae. Payment abatements refer to an incentive provided to the borrower by an interested party, in which the interested party provides funds to pay (or reimburse) a certain number of monthly payments on the borrower’s behalf. The monthly payments may cover, in whole or in part, principal, interest, taxes, and insurance (PITI) as well as the payment of condominium, PUD, or cooperative fees. These funds are provided to the lender at closing in a lump sum to be distributed over the term of the abatement period.

Part X, Underwriting and Guidelines, Chapter 6, Assets and Funding for Closing, Section 602.03 Undisclosed Seller Contributions provides a list of IPCs that are not permissible if they are not disclosed on the HUD-1 Uniform Settlement Statement (HUD-1). Principal and interest (P&I) abatements are included on the list of examples of IPCs that are impermissible if not disclosed. We are clarifying that P&I abatements are ineligible, regardless of whether they are disclosed on the HUD-1. In addition, this applies to transactions in which an interested party is directly funding the abatement and/or if the funding for the abatement is flowing through another entity such as a non-profit down payment assistance program (DAP).
Calculation of IPCs

The percentage of IPC limits and the basis for the limits currently in the Selling Guide are not changing; the basis for the limit will continue to be the CLTV ratio. The CLTV ratio is determined by dividing the sum of the unpaid principal balance of the first mortgage, the unpaid principal balance of a home equity line of credit from which the borrower has withdrawn funds, plus the unpaid principal balances of all other subordinate financing by the lesser of the property’s sales price or its appraised value. In the event a loan has mortgage insurance (MI) that is being financed in the loan amount, the CLTV ratio must be calculated on the loan amount including the amount of the financed MI premium.

The maximum allowable IPCs for conventional mortgages are limited to:

<table>
<thead>
<tr>
<th>Occupancy</th>
<th>CLTV</th>
<th>Maximum Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment</td>
<td>All</td>
<td>2%</td>
</tr>
<tr>
<td>Principal Residence or Second Home</td>
<td>≥ 90.01%</td>
<td>3%</td>
</tr>
<tr>
<td></td>
<td>75.01% - 90.00%</td>
<td>6%</td>
</tr>
<tr>
<td></td>
<td>≤ 75.00%</td>
<td>9%</td>
</tr>
</tbody>
</table>

When IPCs exceed these limits they are considered sales concessions. For underwriting and eligibility purposes, the underwriter must make a downward adjustment to the property’s sales price to reflect the amount of any contributions that exceed the maximum limits. The maximum LTV/CLTV ratios must then be calculated using the lesser of the reduced sales price or appraised value.

Allowable Uses of IPCs

IPCs may not be used to supplement the borrower’s down payment, or to meet minimum contribution requirements or reserve requirements. This pertains not only to funds paid directly from the interested party to the borrower, but also to any funds that flow from an interested party through a third party organization (including nonprofit entities) to the borrower or to the transaction on the borrower’s behalf.

When an interested party donates funds to a third party, which then provides the money to pay some or all of the closing costs for a specific transaction, we consider the funds to be an IPC subject to our limits. The third party often refers to these programs as DAPs. We are retaining the current policy that allows IPC funds that flow through a DAP to be used for allowable closing costs and prepaids in compliance with our limits as described above.

Appraisal Review for Transactions with IPCs

As a reminder, we require that appraisers be provided with all IPCs (Part XI, Property and Appraisal Guidelines, Chapter 2, Appraisal (or Property Inspection)) including both financing and sales concessions for the subject property that will be, or have been, granted by any interested party.
Lenders are reminded that positive adjustments for sales or financing concessions are not acceptable. For additional detail regarding the adjustments for financing and sales concessions, refer to Selling Guide, Part XI, Property and Appraisal Guidelines, Section 406.05.

**Document Review Guidance**

All loan and sales contract documents must be scrutinized with particular care when there is an IPC involved in the transaction. These documents include: the sales contract; Good Faith Estimate (GFE); the Uniform Residential Loan Application (Form 1003), particularly Section VII. DETAILS OF TRANSACTION; the appraisal report; and the HUD-1. All elements of the transaction must flow logically. In other words:

1. The sales contract must summarize all of the financing arrangements negotiated between the buyers and sellers. When an IPC is part of the transaction, it must be included in the contract. All pages and addenda of the contract must be provided to the lender as well as the appraiser. In addition, the appraiser must be provided with IPC information associated with temporary or permanent interest rate buydowns that were funded through a standby commitment that has been provided by the originating lender to the seller/builder (see “Types of IPC’s” above).

2. The GFE summarizes the lenders’ best estimate of expenses that the borrowers should expect to complete the transaction. The relevant financing elements from the sales contract and GFE must appear on Form 1003 in the Details of Transaction Section.

3. The property appraisal must reflect that the appraiser included any and all financing terms and indicate whether the terms affected the property value.

4. The HUD-1 must reflect the final fees and costs, and may not differ substantially from the sales contract, GFE, and Form 1003.

If these documents do not reflect consistent fees and expenses, differences should be analyzed and discrepancies reviewed. The following are some, but not all, areas of concern:

- IPCs in amounts greater than our limits based on the CLTV ratio and transaction type;
- Cash-back on a purchase transaction;
- References to sales contract pages or addendums that have not been provided;
- PITI abatements;
- The appraiser indicates a marketing time that is inconsistent with current market (e.g. quick sale in a market with lengthy marketing times) and no evidence of IPCs;
- Payment of condominium, PUD or cooperative fees by an interested party;
- Contributions on the HUD-1 that were previously undisclosed;
- Subordinate financing on the HUD-1 that was previously undisclosed;
- Subordinate financing that is forgiven or deferred that is provided and/or funded by an interested party;
- Excessive marketing and/or commission fees;
• Commission fees based on a value different than the sales price;
• Guaranteed rental income; or
• Below market interest rates when no buydown subsidy is listed on the HUD-1.

The HUD-1 is a critical record of the transaction. IPCs are easily identifiable when there is a debit on the seller’s side and credit on the borrower’s side of the HUD-1; however, IPCs may be present even when the borrower is not directly credited. Many scenarios have been recently presented where there is not a direct credit to the borrower, but rather a deposit to a reserve account or a payment to a third party. These must be taken into consideration because they may be a way to conceal an IPC. All debits to the seller’s side must be analyzed regardless of who or what is being credited.

The lender is ultimately responsible for warranting that the transaction meets our guidelines, and must ensure that:
• Any and all IPCs have been identified and taken into consideration;
• The lender provided the appraiser with all appropriate financing data and sales concessions for the subject property granted by anyone associated with the transaction;
• The property value is adequately supported;
• The LTV and CLTV ratios, after any IPCs are taken into consideration, remain within our eligibility limits for the particular product; and
• The proper mortgage insurance coverage, if applicable, has been obtained, based on the LTV ratio after any IPC adjustments have been made.

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Lenders who have questions about Announcement 07-23 should contact their Customer Account Team for additional information.

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