Maturing Balloons Frequently Asked Questions (FAQs)

November 2010

Q1. Does Fannie Mae accept deliveries of maturing balloon mortgages with a conditional right to modify?

In Announcement 97-04, Fannie Mae stated it would no longer accept delivery of balloon loans that had a conditional right to modify, requiring all balloon loans to have a conditional right to refinance. The standard modification rider was retired at that time. Fannie Mae only accepts deliveries of balloons with a conditional right to refinance rider.

In addition, Announcement SEL-2010-06, dated April 30, 2010, *Selling Guide Updates*, indicated the retirement of balloon mortgage loans. The Announcement stated that lenders may continue to deliver balloon mortgage loans previously owned or securitized by Fannie Mae after the conditional right to refinance has been executed. The *Selling Guide* update removed all references to balloons as a standard product.

Q2. Why does Fannie Mae require that its maturing balloon mortgages be refinanced instead of modified?

Our requirement is based on our consideration of several tax issues, particularly in regards to balloons that are pooled into a Fannie Mae Mortgage-Backed Security (MBS).

Q3. Which mortgage documents contain the terms and conditions for the conditional right to refinance?

The Balloon Note Addendum and Balloon Security Instrument Rider contain identical language regarding the terms and conditions of the conditional refinance option. The documents also contain the responsibilities of the servicer and borrower, such as deadlines for notifications, when and how the borrower's new interest rate must be determined, calculating the borrower's new payment, and the costs the servicer may charge the borrower as part of the refinance transaction.

Q4. Does Fannie Mae provide servicers with any notification of balloons loans that are reaching maturity?

The Final Maturity Due Report that is generated monthly can assist servicers in identifying balloon mortgages that are approaching maturity. The report includes a listing of all balloon mortgages that our records indicate will have a final maturity date in the next 12-month period.

Q5. What does Fannie Mae mean by "refinance"?

In order to be considered a refinance for Fannie Mae's purposes, the balloon note must be satisfied and a new fixed-rate note must be executed in its place. Servicers may use a streamlined refinancing process when a borrower satisfies the eligibility conditions for a conditional refinance option (or our authorized variances to them). Refer to the *Fannie Mae Servicing Guide*, Part III, 803, for specifics on processing an approved transaction.

Q6. What eligibility conditions must the borrower meet in order to be approved for the refinance?

There are five conditions that must be met before a balloon mortgage can be refinanced or modified when it reaches maturity:

1. The borrower must submit a written request for the refinancing of the mortgage to the servicer no later than 45 days before the balloon maturity date;
2. The borrower's monthly payments must be current and the borrower cannot have been 30 days or more late in making any of the 12 scheduled monthly payments that immediately precede the effective date of the refinancing of the balloon mortgage;
3. The borrower must still own the property and occupy it as his or her principal residence;
4. The property must not have any liens against it other than the lien of the balloon mortgage (except for liens for taxes and special assessments that are not yet due and payable); and
5. The interest rate of the new refinance mortgage must not be more that 500 basis points (5%) higher than the interest rate of the original balloon mortgage.

Q7. Can a borrower who does not meet all five eligibility conditions be approved for the refinance?

Yes, under certain circumstances. As long as the borrower satisfies the eligibility **conditions or our authorized variances** as specified in the *Servicing Guide*, the servicer may approve the refinance. However, the servicer must also make sure it is in compliance with any requirements of the mortgage insurer, if applicable.

Q8. Under what conditions can a borrower who no longer occupies the property securing the balloon mortgage be authorized for the refinance?

As indicated in Fannie Mae's *Servicing Guide*, Part III, 802.03, we may permit a servicer to approve a refinance of a balloon mortgage even though the borrower is technically ineligible because he or she no longer occupies the property as a principal residence or second home. When the borrower still owns the property, but uses it as an investment property, the servicer may authorize the refinancing in accordance to the parameters indicated in the *Servicing Guide*. Servicers should check with the applicable mortgage insurer to obtain its requirements for extending new financing for non-owner-occupied properties.

Q9. Does a balloon loan covered by mortgage insurance have to be handled any differently than a non-insured balloon loan?

The specific requirements for each mortgage insurance company may differ. The servicer should contact the mortgage insurer for its specific requirements.

Q10. When must the servicer notify the borrower that the balloon is reaching maturity?

As indicated in Fannie Mae's *Servicing Guide*, Part III, 801, the borrower must be notified not later than 60 days before the balloon maturity date. However, some states (e.g., California) may require that the borrower be given earlier notice. Fannie Mae recommends, but does not require, that this notice be given as much as a year in advance of the maturity date.

Q11. How does the borrower notify the servicer that he or she wants to exercise the conditional refinance option?

As indicated in Fannie Mae's *Servicing Guide*, Part III 801.02, the borrower must notify the servicer in writing of his or her intent to exercise the refinance option no later than the 45th day before the balloon maturity date. We have developed a Declaration of Intent form that the servicer can provide to the borrower to facilitate this notification. Although we recommend its use, servicers and borrowers are not required to use the Declaration of Intent form.

Q12. Is there any interest rate risk to the servicer?

As indicated in Fannie Mae's *Servicing Guide*, Part III, 801.03, it is possible that servicers could face some interest rate risk. When a borrower submits his or her written request to exercise the conditional refinance option, the servicer is obligated to base the borrower's new interest rate on the applicable Fannie Mae required net yield in effect on the date and time of day it receives the borrower's request. Because interest rates can fluctuate between the date the borrower's request is received and the date the new refinance loan is delivered to Fannie Mae, there is potential for interest rate risk.

To minimize this interest rate risk, the servicer (or its secondary market department) may obtain a negotiated mandatory delivery cash commitment at the same time and date that it receives the borrower's written request to exercise the conditional refinance option. If the servicer prefers to wait until later to request its commitment to deliver the new refinance mortgage, it may select the standard, discount, or premium pricing options (refer to the *Selling Guide* for more information about these pricing options).

Q13. What options does the servicer have for documenting the refinance?

There are three ways to document the refinancing of a balloon mortgage:

1. The execution of a new fixed-rate note and the execution and recordation of a new mortgage (or deed of trust).
2. The execution and recordation of a Balloon Loan Refinancing Instrument (Form 3269 series).
3. For balloon mortgages secured by properties located in New York, a servicer may utilize our Standard Consolidation, Extension, and Modification Agreement (Form 3172) provided the servicer ensures that the use of this document for the refinancing of a balloon mortgage is enforceable and consistent with customary practice in that state.

A servicer may **not** under any circumstances use the Loan Modification Agreement (Form 3179) to document the conditional refinancing of a balloon mortgage.

Q14. How long before the balloon maturity date can a balloon loan be refinanced?

The effective date of the refinance may be up to six months prior to the balloon maturity date.

Q15. How long after the loan is refinanced does the servicer have to deliver the new refinance loan to Fannie Mae?

Servicers have 60 days from the effective date of the refinance to deliver the new loan to us.

Q16. If a servicer refinances a maturing balloon that was sold to Fannie Mae for cash, can the servicer keep the same loan number for the refinanced loan that is delivered to Fannie Mae?

No. The servicer should calculate the payoff and remit the funds to Fannie Mae. The refinanced balloon will be redelivered and assigned a new Fannie Mae loan number.

Q17. Should the term of the new refinance loan be 23 years if the effective date is prior to the balloon maturity date?

The term for a new balloon refinance loan must be 23 years even if the effective date of the refinancing occurs prior to the balloon maturity date.

Q18. Is flood insurance required for the new refinance loan?

If the balloon mortgage was not covered by flood insurance when it was sold to us because the property was not located in a Special Flood Hazard Area, the servicer must verify that the area in which the property is located has not been reclassified as a Special Flood Hazard Area. If the area has been reclassified, the borrower must obtain flood insurance coverage for the new refinance loan.

Q19. How should servicers handle balloons that reach maturity but have not been refinanced?

If a balloon mortgage is not eligible for refinancing according to the terms and conditions of the related legal documents, or in instances where no response was received from the borrower and the balloon maturity is reached, the servicer should pursue standard loss mitigation options and submit the mortgage loan through the HomeSaver Solutions® Network (HSSN), which is accessible via the Asset Management Network (AMN) page on eFannieMae.com.

Q20. What if the borrower has kept the loan current up to maturity, but does not qualify for a refinance?

At maturity the loan is considered to be in default because of the failure to pay the balloon payment, even if the loan was kept current up to the maturity date. If the borrower does not qualify for a refinance, loss mitigation alternatives should be pursued in order to change the contractual terms of the loan.

Q21. Can servicers accept monthly payments from the borrower after the maturity date?

No, the payment terms of a balloon require that the borrower pay the loan in full on or before the maturity date, not the date by which amortization of the loan would yield a full payoff. Servicers may not continue to accept monthly payments from borrowers after the maturity date.