You Should Learn More About These Loan Options

Fannie and Freddie offer attractive alternatives to tried-and-true FHA financing

By Francis A. Betancourt-Molina

Since 1934, Federal Housing Administration (FHA) loans have proven to be a popular choice for first-time homebuyers and low- to moderate-income borrowers, or those with less-than-stellar credit histories. FHA loans offer buyers several advantages, including low downpayments, seller contributions of up to 6 percent of the sales price and other flexible financing options.

With more than 80 years of history as a home-loan program, name recognition alone helps FHA stand out as an option for borrowers. It's not the only option, however, when it comes to mortgages designed to serve these homebuyers. In recent years, government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac have both introduced affordable mortgage programs that offer similar benefits: Freddie Mac's Home Possible Advantage, introduced in December 2014; and Fannie Mae's HomeReady, introduced in September 2015. Both of these products require a 3 percent downpayment, which is lower than the 3.5 percent downpayment required for FHA-backed loans.

Some originators favor FHA loans because they simply are unaware of how these newer products compare. Those originators who gain a better understanding of these products, however, can better serve home-buyers — and generate more business in the process.

Home Possible Advantage

Freddie Mac's Home Possible and Home Possible Advantage products were designed to appeal to borrowers who would typically seek FHA loans by allowing for more flexibility in financing terms and features. The Home Possible mortgage offers up to 95 percent loan-to-value (LTV) financing. Home Possible Advantage increases the LTV up to 97 percent — with up to 105 percent for the combined LTV if the borrower is receiving secondary financing, as a form of downpayment assistance, through a Freddie-qualified "Affordable Second" mortgage. The increase LTV up to 97 percent is also available on no-cash-out-refinance mortgages, regardless of who currently serves the first mortgage.

One of the biggest differences between this product and an FHA loan can be found in the mortgage-insurance requirements. FHA requires an upfront mortgage-insurance premium of 1.75 percent of the base loan amount, as well as monthly mortgage-insurance payments regardless of the LTV, whereas Home Possible Advantage does not require an the upfront mortgage-insurance premium, and mortgage insurance is not required if the LTV is 80 percent or less. The difference in the monthly mortgage-insurance rate between these two products may be the difference between qualifying or not qualifying for the mortgage.

Let's examine, for example, a 30-year fixed-rate mortgage with a loan amount of $250,000. For an FHA loan, with a maximum LTV is 96.5 percent, a 1.75 percent upfront mortgage-insurance premium is required as well as a monthly premium payment for the life of the loan. Home Possible Advantage with a 97 percent LTV will not have an upfront mortgage insurance premium, only a standard monthly mortgage-insurance premium that terminates once the LTV reaches 80 percent.

Oftentimes, the borrower's monthly mortgage payment is lower under the conventional Home Possible Advantage mortgage as compared to an FHA mortgage because of the reduced monthly mortgage-insurance premium required, thus making this product an attractive option for borrowers on a budget.

What's especially attractive about this product is that its flexible features do not require borrowers to be first-time homebuyers to qualify. All borrowers must occupy the property. The borrowers' annual income cannot exceed 100 percent of the area's median income, or in a high-cost area, the borrowers' annual income can exceed the area's median income by a specified percentage indicated by Freddie Mac's income-eligibility search tool. Income limits are waived, however, for properties located in low-income census tracts or designated disaster areas.

Homebuyer education is only required when all borrowers are first-time homebuyers or when the borrowers do not have an established credit history on either a purchase or

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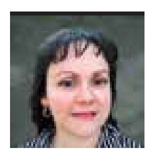

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refinance transaction. This requirement can be met when at least one borrower completes the homebuyer education program or homeownership counseling.

Freddie Mac offers a free literacy curriculum, called CreditSmart, that fulfills the homebuyer-education requirement. Alternatively, borrowers can enroll in financial literacy courses from a Department of Housing and Urban Development (HUD)-approved non-profit agency or enroll in a free homeownership course offered by a private mortgage-insurance company.

HomeReady

Fannie Mae's HomeReady mortgage provides competitive features that also appeal to low- to moderate-income borrowers. Like Home Possible Advantage, this product offers financing up to 97 percent LTV and also is not limited to first-time homebuyers. At least one borrower is required to complete homeownership education from an approved list of sources.

Fannie Mae's Framework program can be completed online at any time prior to loan closing and requires a $75 registration fee. A homeownership counseling agent from a HUD-approved nonprofit counseling agency also can provide the education, so long as the course is completed prior to the borrower signing a purchase contract. Mortgage-insurance providers do not qualify as an approved source for homebuyer education through the HomeReady program.

Borrowers must meet specific criteria to qualify for a HomeReady mortgage. Household income is limited to 100 percent or less of the area's median income. Income limits are waived for low-income census tracts. Non-occupying co-borrowers may be on the loan, even if they already own a home, however. The LTV is reduced to 95 percent in these cases.

A limited cash-out option is available for borrowers seeking to refinance with a HomeReady loan. Refinancing LTV maximums are set at 95 percent for mortgages not actively owned by Fannie Mae, and 97 percent for loans that are owned or serviced by the GSE. Similar to Freddie Mac's Home Possible Advantage program, HomeReady allows up to 105 percent for the combined LTV if the borrower is receiving secondary financing through a Fannie-qualified "Community Seconds" mortgage.

Details in common

Both of these GSE loans options offer similar, yet distinct, features based on the borrower's income, the location of the home, homebuyer education-course options and whether all borrowers will live in the home. Now, let's explore a few details these products have in common.

Both GSE home-loan products allow for flexible financing options, as well as reduced mortgage-insurance rates when compared to FHA loans, and the ability to terminate the monthly mortgage insurance coverage once the LTV ratio is at 80 percent or lower. Additionally, these products allow for flexible downpayment sources, including gifts and "mattress money" (money saved at home).

For cash saved at home, borrowers will be required to verify the source of the money and the time it took to save and deposit it with a financial institution prior to the loan closing. This makes homeownership possible for borrowers who may have little to no credit as a result of limited experience banking with a financial institution.

Boarders income from a roommate or cohabitant can be counted as income for repayment of a loan for each of the GSE options. Borrowers must be able to provide proof of receipt of this income, which could include voided checks and proof of shared residency. Downpayment assistance through a qualified second-mortgage source gives Home Possible Advantage and HomeReady borrowers the option to achieve home-ownership with a combined LTV up to 105 percent.

Ready to choose

With a flexible source of funds for closing financing options, a downpayment of only 3 percent — versus 3.5 percent for FHA — as well as higher LTV options and the discounted cost for mortgage-insurance premums, it's easy to see why Home Possible Advantage and HomeReady are competitive with FHA loans. So why do so many originators still prefer FHA products?

First, and perhaps most importantly, FHA is a widely understood product. Its longevity means originators at all stages of their careers are familiar with its requirements and know how to advise borrowers through the underwriting process.

Second, FHA loans remain popular with borrowers with no (or extremely low) credit. Home Possible Advantage and HomeReady typically require a minimum credit score of 620. FHA loans may be manually underwritten by an institution with an appetite for taking on more credit risk.

Finally, FHA loans allow contributions of up to 6 percent from an interested third party regardless of LTV. These contributions are limited to just 3 percent for Home Possible Advantage and HomeReady mortgages in which the LTV is 90 percent or more.

For qualified borrowers, a Home Possible Advantage or HomeReady mortgage can offer significant cost savings over an FHA loan — not just in the lower downpayment, but throughout the life of the loan. Originators who are committed to finding the best product for their borrowers should be able to clearly articulate the eligibility criteria, income-verification process and homebuyer-education requirement for these products to borrowers and real estate agents.

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FHA loans will likely always be a staple mortgage product for our industry. The dynamics of the housingmarket, however, are always in a state of change, making the need for additional financing options for low- and moderate-income buyers a critical component to affordable homeownership. ■