New Government Mortgage Rules and How They Will Affect You

March 29, 2011 - This week, several government agencies are set to adopt a rules proposal for home mortgages that is likely to have a dramatic affect on housing markets nationwide. Among other things, the rules would require most borrowers to put 20% down on a home purchase and would exclude borrowers who had even a single 60 day late payment on their credit history. Loans requiring a lower down payment or for those without stellar credit will still be available but they will likely be harder to get and more expensive. The rules are likely to exclude nearly 22 million people from the housing market and could very well force another drop in housing prices.

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The proposed new rules for mortgages are a result of last year's Dodd-Frank financial reform bill. They will be phased in over time, in a process that is likely to be painful to homeowners, lenders, borrower and the real estate industry.

The Dodd-Frank bill required that when banks sell the home loans they make to investors, they keep at least 5% of their interest in the loan unless it is a "qualifying residential mortgage" (QRM). The goal of this portion of the law was to insure that lenders still have some skin in the game if the loans they make go bad. These new rules define what a QRM actually is; and that is important since when banks sell QRMs to investors they don't need to maintain any ownership in the original loan.

Under the proposed rules, to qualify for a QRM borrowers will have to put 20% down on any home that they purchase. They will also have to provide documentation on their income, their employment history and their assets. Borrowers who have a single 60 day late payment anywhere on their credit history would not qualify for a QRM at all. This is very similar to the way that the mortgage industry worked twenty years ago.

The rules would not apply to FHA mortgages (which are not QRMs) but would likely result in significantly higher insurance payments for FHA loans. Currently, borrower can put down as little as 3.5% when purchasing using FHA. Mortgage insurance payments on these loans are lumped into the monthly payment. The end result will be higher monthly payments for consumers.

The rules are also likely to exempt loans that are guaranteed by Fannie Mae and Freddie Mac as long as they are controlled by the federal government. This is being done in an attempt to prevent another fall in housing prices but it is probably a mistake since it exposes taxpayers to even more risk. Since the federal government took over Fannie and Freddie, taxpayers have been forced to pay more than $150 billion due to bad loans guaranteed by these agencies.

This rule change is necessary but it is going to cause a lot of pain as it is implemented. This is especially true for homeowners and borrowers who live in high-cost markets such as Manhattan and Los Angeles. By the time the rules are

fully implemented, any home costing more than $729,500 - the highest amount that can be borrowed and still be a conforming loan - will be much harder to sell because borrowers will either need a 20% down payment or they will be forced to pay much higher interest rates even if they have no history of credit issues. Complicating the situation further is the fact that the government may actually reduce the amount for conforming loans.

The proposal also makes it much more important for anyone considering a home purchase to review their credit report regularly for inaccuracies. Not doing so could force you into making the choice of using a higher priced non-QRM loan or being excluded from the housing market altogether.

byJim Malmberg
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