

GVMS Announcement 3-11-2010

Definitions and Tips on Refinances

Since many of our Clients have questions regarding aspects of refinancing loans in Texas, we hope that the following is helpful:

For the other 49 states in the US, there is no distinction about taking cash from the refinancing of any residential mortgage loan. Only Texas has the concern of the Texas Cash out. FNMA writes their DU programming to apply to the widest possible borrower universe, and cannot do more than identify every loan from Texas that is tagged as a refinance to be checked for the application of the Texas Cash out Section 50(a)6 regulations. Every set of DU findings requested for a refinance will have the following paragraph:

“Lender must determine whether Texas Constitution Article XVI, Section 50(a)6 will apply to this refinance loan. Fannie Mae’s classification as a limited cash-out refinance cannot be relied upon for that determination.....”

Additionally, the other 49 states permit refinancing through FNMA that does allow for the borrower to take cash from the closing table. Since its 49-1, again FNMA writes for the broadest application, and so they long ago determined their definition for “limited cash out” versus “cash out”. Limited cash out, when it was first defined, referenced a “limit” of the lesser of 2% of the loan amount or \$2000, which FNMA determined was a reasonable amount of money with which to cover minor unexpected closing costs, or the lack of same. Cash out loans are defined as one where the borrower will be receiving more in cash. Depending on other state specific limitations, a borrower could receive substantial cash out of their homes. They could literally “cash out” their equity, and benefit from that value during their period of ownership rather than only when the home was sold outright.

Texas didn’t allow any cash out on a refinance for many years, so every refinance in Texas became a “limited cash out refinance”, simply to serve FNMA’s definition. A limited cash out to FNMA in Texas was a rate and term refinance that merely lowered a borrower’s interest rate to current market, or lowered the term of the amortization, so that the loan paid off more rapidly. There was no cash permitted to be paid to the borrower at closing at all, and that is still true.

When Texas law was changed to permit some cash out of equity provisions, many stipulations were placed on the new loans, to act as a deterrent to homeowners who might want to take all their equity and weaken their investment position in their home. A Texan has to maintain a 20% equity position, and the home must always be refinanced in future as a Texas Cash out, at a typically higher cost. “Once a cash out, always a cash out” until the home actually changes owners entirely. Only a paid in full loan ends the cash out stipulations.

As other markets for home ownership matured, and custom home building became increasingly popular, lenders met that demand with ways to offer the financing for construction of homes on land already in title to the interested homeowner.

Community banks were interested in making shorter term construction loans, with the assurance that the permanent mortgage would be obtained at the conclusion of the construction period. The bank would be “taken out” of the construction loan, and others would originate the permanent mortgage. FNMA provides the underlying financing for the permanent loan that is sold to a variety of permanent mortgage lenders in the secondary market.

For years, little distinction was made by FNMA regarding these construction loans, and the secondary market permitted these loans to be considered and priced just like rate and term refinances. But in evaluating the recent downturn in the economy, and in an attempt to better their delinquency outlook, FNMA initiated new criteria regarding a refinance. They developed their own criteria, applicable to all 50 states, which defined their concept of a cash out –or what we will call an “agency” cash out. It has become critical to select the appropriate answer to two seemingly innocuous questions whenever you are loading a refinance into DU in order to get the accurate findings you need, and to know if your lender has additional pricing requirements on the particular type of refinance.

The two questions are: Loan Purpose and Refi Purpose.

For the several types of refinanced loans secured by residential real estate for which FNMA offers financing, we are providing terms and definitions. The following is a list of the variables that we see most often in Underwriting:

- 1. An ordinary refinance, simply for rate and term:
Select Loan Purpose as Refinance
Select Refi Purpose as Limited Cash out**

- 2. The refinancing of a construction note, which is being permanently financed and for which the land was free and clear when construction began:
Select Loan Purpose as Refinance
Select Refi Purpose as Construction to Perm**

- 3. The refinancing of a construction note, which is being permanently financed and for which the land has an existing, distinct lien.**

There should be no lien remaining against the land when you close your construction loan. Any land lien should be paid off by the construction loan, and the land must be owned free and clear. When that is accomplished:

- Select Loan Purpose as Refinance**
- Select Refi Purpose as Construction to Perm**

4. The refinancing of an existing home, which has been enlarged or improved in some way. There should be a Mechanics and Material men's Lien filed for the cost of the improvement. This is an "agency" cash out.

Select Loan Purpose as Refinance

Select Refi Purpose as Cash out

4(a) There is one exception to #4 above – if there were two liens done (A 1ST and 2nd) at the time of the original loan closing, both can be refinanced together into one lien as a limited cash out. Your data input would be:

Select Loan Purpose as Refinance

Select Refi Purpose as Limited Cash out

5. The refinancing of an existing home, that has substantive equity, and the owner desires to benefit from the value of that equity up to the state of Texas limits. This is a Texas Equity Section 50(a)6.

Select Loan Purpose as Refinance

Select Refi Purpose as Cash out

Under #2-5 of the preceding scenarios, your findings will state the following, in two paragraphs under RISK/ELIGIBILITY

“If any subordinate lien that was not used to acquire the subject property is to be paid off with first mortgage proceeds, the loan is ineligible as a limited cash out refinance. The loan must be resubmitted as a cash-out refinance.” (THIS IS A STIPULATION OF AN AGENCY CASH OUT. This does not make your subject loan a Texas Cash out under Section (50)a6.)

Your findings will also state:

“This loan case file has been underwritten as a cash-out refinance. If the originating lender held the first mortgage being paid off with this transaction for less than 6 months prior to the date of the application, the lender must review the short term financing guidelines and determine whether this transaction is still eligible for delivery to Fannie Mae as a limited cash-out refinance. In addition, the property must not be currently listed for sale.” (Again, this makes your loan an “agency” cash out, but not a Texas Cash out). The test to meet is on the seasoning of the construction loan you are paying off. It must have been on the books for not less than 6 months from the date of the permanent loan application.

It will be necessary to comply with both of these findings in order to comply with FNMA and to make the subject loan marketable. FNMA's short term financing rules are further described in the 2009 Sellers Guide, Section B2-1.2-02.

You will also observe in your findings that FNMA provides “Special Feature Codes”. Most of us have paid little attention to this information, and left it to those who ship the loans to provide these loan-specific codes at delivery. Please be aware

that Investors' pricing strategies are often based on these Special Feature Codes, and entering your data correctly into DU is the way to insure that your pricing and lock-in quote to your borrowers is both correct and profitable.

These Special Feature Codes consist of several options. In their usual order of appearance, they are:

**304 Texas Equity Take Out Mortgage (if applicable) - you decide this
127/214 Desktop Underwriter (DU) loan (as opposed to a manual underwrite)
003 Cash-refinance (an "agency" cash out)**

It will be important in your pricing to affirm that these codes are accurate and conform to your RISK/ELIGIBILITY findings, as each permanent lender has their own policy and practice in pricing with these Special Feature Codes in consideration.

If you should have a refinance request that isn't described by the preceding examples, please contact us for guidance. We're here to help!

ONE LAST THING

The last confusing item is regarding seasoning on the land in the transaction, for the determination of property value. If the land has been owned less than 12 months, irrespective of the type of refinance you have, you must use the Acquisition Cost of the property. This is determined by taking the amount paid for the property when acquired, and adding the construction contract cost to that figure, for a total value to acquire.

If the borrower has owned the land for 12 or more months, the value can be established by a current acceptable appraisal. This can actually be more or less than the cost to acquire, depending on the strength of the market area of the subject property.

In all cases, a close review of the DU findings will identify both requirements and inconsistencies in your input. Matching the DU findings will make your loan sail through!

For additional information on this information, you can always go to www.efanniemae.com.