Fannie Mae: What It Does and How It Operates

There's a very good chance you've heard of Fannie Mae. But do you know what it does and how it operates?

The Federal National Mortgage Association (FNMA), typically known as Fannie Mae, is a government-sponsored enterprise (GSE) founded in 1938 by Congress during the Great Depression as part of the New Deal. It was established to stimulate the housing market by making more mortgages available to moderate- to low-income borrowers.[1]

Fannie Mae does not originate or provide mortgages to borrowers. But it does purchase and guarantee them through the secondary mortgage market. In fact, it's one of two of the largest purchasers of mortgages on the secondary market. The other is its sibling, the Federal Home Loan Mortgage Corporation, or Freddie Mac, another government-sponsored enterprise created by Congress.

KEY TAKEAWAYS

- Fannie Mae is a government-sponsored enterprise that makes mortgages available to low- and moderate-income borrowers.
- It does not provide loans but backs or guarantees them in the secondary mortgage market.
- Fannie Mae provides liquidity by investing in the mortgage market, pooling loans into mortgage-backed securities.
- Fannie Mae was bailed out by the U.S. government following the financial crisis and was delisted from the NYSE.
- Fannie Mae's Early Days

Credit Options

Fannie Mae now offers several different business initiatives and credit options to homeowners, working with lenders to help people who may otherwise have difficulties obtaining financing.

- **HomeReady Mortgage:** This product allows homeowners to secure financing and purchase a home with a low-down payment. Borrowers qualify if they have low to moderate-income and a credit score below 620. People with scores above 620 get better pricing.

- **3% Down Payment:** Another resource for homeowners who may not have access to enough funds to secure a large down payment.
- **HFA Preferred:** This program helps homeowners access affordable financing through local and state Housing Finance Agencies and other lenders. Income levels for borrowers are determined by the HFA, and there are no first-time buyer requirements.
- **RefiNow**: Fannie Mae offers low-income mortgage holders a new refinance option through their “RefiNow” program. The program requires a reduction in the homeowner’s interest rate by a minimum of 50 basis points and a savings of at least $50 in the homeowner’s monthly mortgage payment. To be eligible, homeowners must be earning at or below 80% of their area median income (AMI).

A full list of products and their descriptions are available on Fannie Mae's website.

Loan Modifications

Following the mortgage meltdown, Fannie Mae began to focus on loan modifications. Since September 2008, Fannie Mae and Freddie Mac have completed roughly 2.37 million loan modifications. Loan modifications change the conditions of an existing mortgage to help borrowers avoid defaulting on their mortgages, ending up in foreclosure, and ultimately losing their home. Modifications can include a lower interest rate or extend the term of the loan. Loan modification can also lower monthly payments.

The Bottom Line

Fannie Mae has managed to turn itself around since being on the brink in 2008. Today it is the largest backer of 30-year fixed-rate mortgages and remains a key mechanism for facilitating homeownership.

Do you want to learn more about Fannie Mae?

Well, keep on reading below…

History:

In the early 1900s, getting a mortgage—let alone a home—was not an easy task. Many people couldn't afford to secure a down payment, and loans were almost always short-term—not like those with the long-term amortization periods we know of today. In fact, when many of the loans came due at the time, they normally called for large balloon payments from the debtor.

The bank would foreclose if the homeowner couldn't make the payment or refinance. That would become difficult with the onset of the Great Depression. Annual foreclosure rates rose every year from 1926 (the first-year figures were kept) until 1934, when the rate peaked at well over 12%.

The United States Congress responded by creating Fannie Mae. The aim was to help create a stream of housing funding available to everyone in every market. This led to the financing of long-term fixed-rate mortgages, allowing homeowners to refinance their loans at any point during the course of their loan.

1938 *The year Congress created Fannie Mae.*

In 1968, Fannie Mae began funding itself by selling stock and bonds after the government removed it from the Federal Budget. Fannie Mae retained its ties to the government as a GSE, though, with a board of directors comprised of no more than 13 members. It is also exempt from local and state taxes.

Creating Liquidity

By investing in the mortgage market, Fannie Mae creates more liquidity for lenders such as banks, thrifts, and credit unions, which in turn allows them to underwrite or fund more mortgages. The mortgages it purchases and guarantees must meet strict criteria. For example, the limit for a conventional loan for a single-family home in 2021 is $548,250 (up from $510,400 in 2020) for most areas and $822,375 (up from $765,600 in 2020) for high-cost areas. These areas include Hawaii, Alaska, Guam, and the U.S. Virgin Islands, where average home values are above the baseline amount by at least 115%.

In order to do business with Fannie Mae, a mortgage lender must comply with the Statement on Subprime Lending issued by the federal government. The statement addresses several risks associated with subprime loans, such as low introductory rates followed by higher variable rates; very high limits on how much an interest rate may increase; limited to no income documentation; and product features that make frequent refinancing of the loan likely.

In 2020, Fannie Mae acquired $1.4 trillion in single-family and multifamily loans, providing the largest amount of liquidity to the mortgage market for any year in Fannie Mae's history. This helped people across the country buy, refinance, and rent about three million homes.

***Fannie Mae backs or guarantees mortgages but does not originate them.**

Mortgage-Backed Securities

After purchasing mortgages on the secondary market, Fannie Mae pools them to form mortgage-backed securities (MBS). MBS are asset-backed securities secured by a mortgage or pool of mortgages. Fannie Mae's mortgage-backed securities are purchased by institutions such as insurance companies, pension funds, and investment banks. It guarantees payments of principal and interest on its MBS.

Fannie Mae also has its own portfolio, commonly referred to as a retained portfolio. This invests in its own mortgage-backed securities as well as those from other institutions. Fannie Mae issues debt called agency debt to fund its retained portfolio.

The Financial Crisis

Fannie Mae has been publicly traded since 1968. Until 2010, it traded on the New York Stock Exchange (NYSE). It was delisted following the mortgage, housing, and financial crisis after its stock plummeted below the minimum capital requirements mandated by the New York Stock Exchange. It now trades over-the-counter.

Unethical lending practices led to the crisis. During the housing boom of the mid-2000s, lenders lowered their standards and offered home loans to borrowers with poor credit. In 2007, the housing bubble burst, and hundreds of thousands of these borrowers went into default, which led to what was known as the subprime meltdown. This had a ripple effect on the credit markets, which sent the financial markets into a tailspin and created the most severe recession in decades in the United States.

Government Takeover and Bailout

In the latter half of 2008, Fannie Mae and Freddie Mac were taken over by the government via a conservatorship of the Federal Housing Finance Committee. At the time, both held $4.9 trillion in bonds and mortgage-backed securities. The U.S. Treasury provided $191.5 billion to keep both solvent. In essence, the U.S. government intervened in order to restore trust in the markets by promising to bail out bad loans and to prevent a further slump in the housing market. As of May 2019, the federal government has received $292 billion in dividend payments from Fannie Mae and Freddie Mac.