



Announcement 03-07

July 31, 2003

(with correction on Attachment 1, page 2)

Amends these Guides: Selling

Purchase of Kentucky and Arkansas “High-Cost Home Loans,” Manufactured Home Mortgages, and Miscellaneous Changes to Lender Relationship and Master Agreement Policies, Mortgage Documents, Mortgage Eligibility Criteria, Underwriting Guidelines, and Community Lending Mortgages

This Announcement includes several Guide changes that are meant to clarify or amend our current requirements or to update policies that have been impacted by recent state laws or federal regulations. Some of the more significant changes that are addressed in this Announcement include:

- an expansion of the list of states that have passed “high-cost home loan” legislation and from which we will not purchase loans that qualify as “high-cost home loans”;
- an explanation of recent Internal Revenue Service regulations that impose reporting requirements on certain transactions;
- a clarification of our current loan limits as they relate to modified loan amounts;
- a description of the enhancements to our InterestFirst® Mortgage product; and
- a clarification of the eligible sources of income and nontraditional mortgage credit requirements, especially as they relate to people with disabilities.

Purchase of Kentucky and Arkansas “High-Cost Home Loans”

Over the past few years, Fannie Mae and its lender partners have worked together to expand affordable homeownership, promote responsible lending practices, and combat predatory lending in numerous ways. Among those efforts are our standards to guard against the

purchase of mortgages with predatory features that were announced in Lender Letter 03-00, which includes a prohibition against the purchase of “high-cost” mortgages under the federal Home Ownership and Equity Protection Act (HOEPA). In that same vein, in Announcements 02-12 and 03-02, we announced that we would not purchase any mortgages that qualify as “high-cost home loans” under the Georgia Fair Lending Act or New York Banking Law §6-1.

The Kentucky high-cost home loan statute (Ky. Rev. Stat. §360.100) became effective June 24, 2003. The Kentucky law, which is intended to combat predatory lending, applies to owner-occupied home loans with a principal balance greater than \$15,000 and equal to or less than \$200,000 and secured by property located in the State of Kentucky. Effective September 1, 2003, mortgage loans may not be delivered to us if they qualify as “high-cost home loans” under the Kentucky law.

On July 16, 2003, the Arkansas Home Loan Protection Act (Act 1340 of 2003), which also is intended to combat predatory lending, became effective for owner-occupied home loans with a principal balance of \$150,000 or less and secured by property located in the State of Arkansas. Effective September 1, 2003, mortgage loans may not be delivered to us if they qualify as “high-cost home loans” under the Arkansas law.

Pursuant to our Mortgage Selling and Servicing Contract, a seller represents and warrants that each mortgage loan it delivers conforms to all applicable requirements of our Selling Guide, which in the case of mortgage loans secured by Kentucky or Arkansas property includes the prohibitions on delivery of “high-cost home loans” (as defined by the laws of those states), which are added to our Selling Guide by this Announcement. Lenders should consult their own counsel to advise them as to the specifics of relevant statutes. We expect a lender that delivers any loan to us that is secured by Kentucky or Arkansas property to have in place across all its business channels a process based on the unique requirements of the relevant laws to ensure that it does not inadvertently deliver a “high-cost home loan” to us. Although at this time we are not publishing specific requirements for such a process, we may do so in the future.

In addition, Fannie Mae will conduct additional quality assurance reviews of mortgages secured by properties in Kentucky and Arkansas and will require immediate repurchase of any determined to be “high-cost home loans.”

Mortgages Secured by Manufactured Homes

In Announcement 03-06 (dated June 3, 2003), we restated and revised our requirements for mortgages secured by manufactured homes. Those changes included requirements related to our appraisal standards for manufactured homes and included a new addendum, the *Manufactured Home Appraisal Report Addendum* (Form 1004C), which expands upon the information required on the *Uniform Residential Appraisal Report* (Form 1004). Because the appraisal of a new manufactured home is often completed prior to delivery of the home, some of the information needed to complete Form 1004C may not be available at the time the appraisal is performed. That information might include the dealer invoice, the U.S.

Department of Housing and Urban Development (HUD) Data Plate, certification label number(s), etc. For information not available at the time the appraiser is completing the appraisal forms, the appraiser can appraise the property subject to his or her receipt and review of the items as a condition of the appraisal. Prior to the delivery of the mortgage to us, lenders should obtain a “certification of completion” from the appraiser that includes the previously unavailable information (including a summary of the appraiser’s analysis of any previously unavailable dealer invoice), and certifies that the requirements and conditions of the appraisal have been satisfied.

Since the release of Announcement 03-06, lenders have suggested that it would be helpful to have a property type field included on the *Uniform Residential Loan Application* (Form 1003) to document the property type that will be securing the mortgage and facilitate processing of the loan application. Neither the current Form 1003 nor the revised Form 1003 included in Announcement 03-03 (dated April 28, 2003) provides a property type field. Because neither the existing nor the new Form 1003 includes a field for property type, we suggest the property type (manufactured home, cooperative, condominium) be inserted into the Legal Description field if lenders choose to do so. This is not required for Form 1003. Lenders may continue using whatever documents or processes they currently have in place for documenting the property type during the origination of the mortgage loan and will continue to be responsible for correctly identifying the property type of loans they deliver to us whether or not the property type is indicated on Form 1003. We may incorporate a property type field on Form 1003 in the future when the form is updated. There are no plans for such an update at the present time, however.

Part I: Lender Relationships

The U.S. Internal Revenue Service (IRS) recently issued regulations that impose reporting requirements on certain transactions in which the tax structure is subject to confidentiality. We are adding one new section and modifying the language in one other section of the Selling Guide to make clear that any confidentiality agreement between Fannie Mae and its lenders does not require confidentiality with respect to the tax structure of transactions. These modifications are effective September 1, 2003. The waiver of confidentiality is limited to the U.S. federal income tax treatment of the transaction and does not include information relating to the identity of the parties. Lenders are advised to discuss any questions with their tax advisors.

Chapter 2, Contractual Relationship, Section 210, Waiver of Confidentiality with Respect to Tax Structure. This section is new and will be republished in the Selling Guide in the next Guide Update.

- Notwithstanding any contractual obligation of the lender or Fannie Mae to maintain confidential certain information, pursuant to Treasury Regulation section 1.6011-4(b)(3)(iii), the lender and Fannie Mae (and each employee, representative, or other agent of the lender or Fannie Mae) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transaction and all materials of any kind (including opinions or other tax analyses) that are provided to the lender or Fannie

Mae relating to such tax treatment and tax structure. For this purpose, “tax structure” is limited to any facts relevant to the U.S. federal income tax treatment of the transaction and does not include information relating to the identity of the parties.

Part III, Mortgage Commitments, Chapter 1, Master Agreements, Exhibit 1, Master Agreement Terms and Conditions. The following new language is added immediately before the last sentence of the first paragraph of Part I, Section G of the Master Agreement Terms and Conditions:

- In particular, pursuant to Treasury Regulation section 1.6011-4(b)(3)(iii), lender (and each employee, representative, or other agent of the lender) may disclose to any and all persons, without limitation of any kind, the tax treatment and tax structure of the transaction and all materials of any kind (including opinions or other tax analyses) that are provided to the lender relating to such tax treatment and tax structure. For this purpose, “tax structure” is limited to any facts relevant to the U.S. federal income tax treatment of the transaction and does not include information relating to the identity of the parties.

Part II: Delivery Options

Chapter 2, MBS Pool Deliveries, Section 208, Sale of Securities. Lenders are already aware that a “read-only” version of the MBS Prospectus is available in electronic format. We want to inform lenders that we now have the capability to provide MBS Prospectus Supplements (and any Supplements to Prospectus Supplements) in the same electronic “read only” format and will do so at the lender’s request. We will provide these documents to the lender by transmitting the “read only” file to the lender’s E-mail address or by other electronic means. As is required for the MBS Prospectus, if the security purchaser requests an original printed version of the MBS Prospectus Supplement (including any Supplement to the Prospectus Supplement), the lender must make sure that it subsequently honors the request in a timely manner. Instructions for obtaining electronic MBS Prospectus and MBS Prospectus Supplement information are available on our website (www.efanniemae.com).

Part IV: Mortgage Documents

Chapter 1, Security Instruments. Lenders are reminded that they may reproduce any of our security instruments as individual letter-sized pages printed on one side only, as individual letter-sized pages printed on both sides, or as any other page size that is necessary to comply with specific state or local recordation statutes. We want to clarify that lenders may also make formatting changes, including adjusting the margins, page size, spacing, or font, if such a change contributes to borrower understanding or ease of use (such as large print) or helps control costs (for example, to avoid incurring additional recordation costs for oversized documents or to reduce the number of pages where recordation costs are calculated on a per-page basis), provided that the resulting documents comply with applicable recording requirements.

Chapter 1, Exhibit 1, Security Instruments for Regularly Amortizing First Mortgages. We understand that instead of employing the January 2001 versions of the security instrument and note, Puerto Rico lenders have continued to use the prior versions. To address their concerns, we have revised the documents to incorporate the provisions of the standard forms used in other jurisdictions with the format consistent with Puerto Rico law and custom. These revised instruments have been posted on our website (www.efanniemae.com). Lenders will be required to use them on and after November 1, 2003, but are encouraged to use them as soon as possible, as the versions prior to January 2001 are and will continue to be nonstandard instruments.

Chapter 1, Section 104, Borrowers' Signatures on Security Instruments; and Chapter 2, Mortgage or Deed of Trust Notes, Section 203, Borrowers' Signatures on the Note. We have received a number of questions about our requirements for signatures on the security instruments and note and have been asked to provide clarification. Generally, the same individuals will sign both the security instrument and the note. However, the requirements concerning signatories are based on the purpose for which the individual is signing.

- Each person who has an ownership interest in the security property must sign the mortgage or deed of trust (or security deed). A person with an ownership interest in the property whose income is not used in qualifying for the mortgage must sign the security instrument (solely to allow the attachment of the lien), but is not required to sign the note. This includes the spouse of any person who has an interest in the property whose signature is necessary under applicable state law to waive any marital property right he or she has by virtue of being the owner's spouse.
- All persons whose income is used in qualifying for the loan must sign the note. An individual who is a cosigner or guarantor but has no ownership interest in the property must sign the note, but is not named in or required to sign the security instrument. (A cosigner or guarantor who has an ownership interest in the property must sign both the note and the security instrument.)

We will accept a note or security instrument signed by an attorney-in-fact on behalf of a person whose signature is required, as long as the lender obtains a copy of the applicable power of attorney. In some jurisdictions, a power of attorney used for a signature on a security instrument must be recorded with the security instrument.

Part V: Mortgage and Property Insurance

Chapter 2, Title Insurance, Section 203, Title Evidence. As evidence of title, we prefer the coverage provided by the American Land Title Association (ALTA) standard policy. However, we will consider other forms of title evidence. We recently reviewed the ALTA Expanded Coverage Residential Loan Policy and concluded it is also satisfactory to us. Because this policy incorporates ALTA endorsements 4 (condominiums), 5 (planned unit developments), 6 (ARMs), 6.2 (ARMs with negative amortization), 8.1 (environmental hazards), and 9 (restrictions, encroachments, minerals), it is not necessary for the lender to obtain these endorsements if this form of policy is used. Endorsements not incorporated in

the policy must be obtained if they are required, e.g. the ALTA endorsement 7 if the property is manufactured housing.

Part VII: Mortgage Eligibility

Chapter 1, Conventional Mortgages, Section 101.06, Inter Vivos Revocable Trusts. Our current policy requires the property securing a conventional first mortgage that has an *inter vivos* revocable trust as the borrower to be a one-family principal residence that is occupied by at least one of the individuals establishing the trust or a one-family second home. We are revising our policy to also permit the property to be a one-family investment property.

Additionally, we currently require full title to the security property to be vested in the trustee(s) of the *inter vivos* revocable trust and there can be no other owners. We are revising this policy to also allow title to be vested jointly in the trustee(s) of the *inter vivos* revocable trust and in the name(s) of an individual borrower(s) or in the trustee(s) of more than one *inter vivos* revocable trust.

Chapter 1, Section 102.09, Inclusionary Zoning Restrictions. We purchase and securitize mortgages that are subject to inclusionary zoning restrictions under the terms and conditions set forth in this section. Under our existing policy, any resale controls that affect the restricted units must be for a fixed period of any term up to 30 years. Because many jurisdictions may have resale controls that are greater than 30 years, we are modifying this policy to eliminate our limitations on the maximum periods for such resale controls.

Chapter 1, Section 104.03, Mortgage Amounts. A modification of a mortgage that Fannie Mae has not purchased for cash or MBS that is executed as an alternative to requiring the mortgage to be refinanced does not result in the creation of a new loan. Therefore, lenders are reminded that a modified mortgage that had an *original* unpaid principal balance that exceeded our current applicable limit (the limit in effect at the time of a proposed sale of the mortgage to us), even though the balance may have been paid down at the time of the modification to or below our current applicable limit, is *not* eligible for purchase by us.

Chapter 1, Section 104.08, Subordinate Financing. For a number of years, Fannie Mae has purchased first mortgages that were originated concurrently with subordinate financing, initially under negotiated contracts, but more recently as part of standard transactions as well. These subordinate financing structures may take the form of a first and a second mortgage used in combination for purchase-money or refinance purposes where the second mortgage is a simultaneously funded closed-end second, a home equity line of credit partially drawn down at the time of closing, or an existing mortgage resubordinated at the time of closing a new first mortgage.

Our research indicates that the presence of subordinate financing increases the risk profile of the first mortgage transaction. Accordingly, our automated underwriting tool, Desktop Underwriter®, factors in the existence of subordinate financing in its risk assessment of loans. Last year, we announced enhancements to our guidelines relating to manually underwritten loans that, among other things, included guidance regarding factoring the existence of subordinate financing into the comprehensive risk assessment of the

transaction. Our ongoing risk analysis of such loans demonstrates that continued close scrutiny is appropriate and that further underwriting, eligibility, and/or pricing changes may be warranted in connection with such transactions in the future.

Recently, our analysis of this loan type also revealed that many lenders are not consistently or properly coding first mortgages that were originated in transactions that include subordinate financing when they deliver the first mortgages to us. Proper coding is critical to our risk review and analysis. The chart presented below contains our current special feature code requirements as well as our loan-level price adjustments associated with first mortgages that were originated in transactions that include subordinate financing. We want to remind lenders to include the appropriate special feature code with all deliveries. Failure to properly deliver special feature codes can result in post-closing loan-level price adjustment reconciliation issues.

Special Feature Code (SFC)	LTV Range	CLTV Range	Loan Level Price Adjustment	Examples of Typical Financing Structures
339	65.01% - 75%	90.01% - 95%	.25%	75/20/5
338	75.01% - 95%	90.01% - 95%	.25%	90/5/5, 80/15/5, 85/10/5
187	75.01% - 90%	76.01% - 90%	0	80/10/10

Note: These price adjustments are not applicable for Community Lending mortgages with a Community Seconds[®] loan.

Lenders are further reminded that the loan-level price adjustment for first mortgages that were originated in transactions that include subordinate financing are in addition to any other loan-level price adjustment that may apply. When delivering a mortgage that has a subordinate financing structure indicated on the chart, the lender must report the applicable special feature code on the *Loan Schedule* (Form 1068 or 1069) or *Schedule of Mortgages* (Form 2005) as well as the applicable loan-to-value ratio and combined loan-to-value ratio. Any loan-level price adjustment will be deducted from the purchase proceeds (if the mortgage is submitted as a cash delivery) or drafted from the lender's designated custodial account (if the mortgage is submitted as part of an MBS pool delivery).

Chapter 1, Section 111, InterestFirst Mortgages. The InterestFirst Mortgage is a 30-year fixed-rate mortgage that allows the borrower to pay only the interest due on the mortgage for the first 10 or 15 years, after which time it becomes fully amortizing. Lenders must obtain approval in their Master Agreements in order to deliver InterestFirst mortgages to Fannie Mae. The eligibility criteria for the fixed-rate InterestFirst Mortgage are presented in this section of the Guide. Lender Announcement 02-12, issued on November 27, 2002, published information concerning an enhancement to the InterestFirst Mortgage. At that

time, we informed lenders that InterestFirst Mortgages were also eligible as standard non-convertible 5/1 ARMs, 7/1 ARMs, or 10/1 ARMs for cash purchases. Effective immediately, InterestFirst Mortgages are *also* eligible as standard non-convertible 5/1 ARMs, 7/1 ARMs, or 10/1 ARMs *for MBS issuance*. In addition, *beginning on September 1, 2003*, InterestFirst 3/1 ARMs will be eligible for delivery for cash purchase or MBS issuance.

InterestFirst ARMs delivered for MBS issuance generally must conform to the same eligibility requirements applicable to InterestFirst ARMs delivered for cash purchase. Eligible property types for InterestFirst ARMs (both cash purchase and MBS issuance) are the same as for fixed-rate InterestFirst Mortgages, namely one-family owner-occupied principal residences. Detached dwellings and units in condominium or PUD projects may be security for an InterestFirst mortgage; manufactured homes and cooperative projects may not. For these adjustable-rate mortgages, the maximum loan-to-value ratio (or combined loan-to-value ratio if there is subordinate financing involved) is 90% for purchase money or limited cash-out refinance transactions and 70% for cash-out refinance transactions. The maximum home equity combined loan-to-value ratio is 95% for purchase money or limited cash-out refinance transactions and 75% for cash-out refinance transactions.

InterestFirst ARMs are tied to the 1-Year Treasury Index (CMT), which is the weekly average yield on Treasury securities adjusted to a constant maturity of one year, or to the 1-year London Interbank Offered Rate (LIBOR) index as published in *The Wall Street Journal*. Eligible CMT-indexed 5/1, 7/1, and 10/1 ARM plans delivered for MBS issuance are Plans 3226, 3227, and 3228, which are the same as Plans 660, 750, 1423 for cash purchase, respectively. The LIBOR-indexed 5/1, 7/1, and 10/1 ARM plans delivered for MBS issuance are Plans 3223, 3224, and 3225, which are the same as Plans 2725, 2727, and 2729 for cash purchase, respectively. (The MBS plan numbers for the 5/1, 7/1, and 10/1 ARMs differ from the cash plan numbers for the same ARM product, even though the plan characteristics are identical.) The ARM characteristics for all InterestFirst ARM plans eligible for both cash purchase and MBS issuance are described in Attachment 1.

The plan numbers for all LIBOR-indexed 5/1, 7/1, and 10/1 ARMs, both for cash purchase and MBS issuance (2725, 2727, 2729, 3223, 3224, and 3225) and the new CMT-indexed 5/1, 7/1, and 10/1 ARMs for MBS delivery (3226, 3227, and 3228) are *not* included in the list of specific ARM plans in Desktop Underwriter. Therefore, the lender should select one of the generic ARM plans – FM Generic 5 Yr, 7 Yr, or 10 Yr (as applicable for 5/1 ARMs, 7/1 ARMs, or 10/1 ARMs) when submitting loans to Desktop Underwriter. While the generic plan names (such as FM Generic 5 Yr) are used to *submit* loans to Desktop Underwriter, the generic plan names must *not* be used in the closing documents or for delivery purposes. The lender must identify the applicable standard Fannie Mae ARM plan number (such as 2725) when delivering the loan to Fannie Mae. For details on delivering loans to Fannie Mae, lenders should refer to the Selling Guide, Part VI, Chapter 3.

The lender is required to enter the following future feature codes in the MBS Pool Submission System for InterestFirst ARMs delivered for MBS issuance: “143” for 5/1 ARMs; “144” for 7/1 ARMs; and “145” for 10/1 ARMs.

InterestFirst 5/1, 7/1, and 10/1 ARMs delivered for MBS issuance must be documented using whatever Fannie Mae/Freddie Mac uniform security instrument is appropriate in the

mortgaged property jurisdiction, together with the applicable “InterestFirst Adjustable Rate Note” - Fannie Mae Form 3531 for CMT-indexed ARMs (Plans 3226, 3227, and 3228) or Fannie Mae Form 3530 for LIBOR-indexed ARMs (Plans 3223, 3224, and 3225).

In addition to other standard loan-level price adjustments, a price adjustment of 0.25% is required when an InterestFirst mortgage is subject to subordinate financing and has a loan-to-value ratio that is greater than 75%. Special feature codes are not required for InterestFirst mortgages with subordinate financing.

Non-convertible InterestFirst 3/1 ARMs will be eligible for cash purchase or MBS issuance beginning on September 1, 2003. The eligibility criteria for the 3/1 ARMs generally are the same as those for the InterestFirst 5/1, 7/1, and 10/1 ARMs, except as specifically otherwise provided.

New ARM plans have been created for the InterestFirst 3/1 ARMs. The CMT-indexed 3/1 ARM uses Plan 3271 and the LIBOR-indexed 3/1 ARM uses Plan 3270 for both cash purchases and MBS issuances. The ARM characteristics for the InterestFirst 3/1 ARM plans are described in Attachment 1.

The InterestFirst 3/1 ARMs will be available in Desktop Underwriter Version 5.3, which is scheduled for release on August 24, 2003. Lenders should select the generic ARM plan option – “FM Generic 3 Yr,” when submitting InterestFirst 3/1 ARMs to Desktop Underwriter. For InterestFirst 3/1 ARMs delivered for MBS issuance, the lender is required to enter the future feature code “244” in the MBS Pool Submission System.

InterestFirst 3/1 ARMs also must be documented using the Fannie Mae/Freddie Mac uniform security instrument appropriate for the mortgaged property jurisdiction, together with the applicable “InterestFirst Adjustable Rate Note” - Fannie Mae Form 3533 for 3/1 CMT-indexed ARMs and Fannie Mae Form 3532 for 3/1 LIBOR-indexed ARMs. InterestFirst 3/1 ARMs are subject to the same loan-level price adjustments as applicable to other InterestFirst ARMs.

Part VIII: Community Lending Mortgages

Chapter 1, General Mortgage Eligibility Criteria, Section 102.01, Borrower Income Limits Imposed by Fannie Mae. Community lending mortgages are designed to assist eligible low- and moderate-income borrowers whose incomes generally may not exceed 100% of the median income that HUD publishes for the area in which the mortgaged property is located. In some localities, an income greater than 100% of the area’s median family income is needed to qualify for a median-sales-priced home. Therefore, we have granted an exception for some high-cost areas and allow higher income limits. The Selling Guide and subsequent Announcements list the areas that are currently eligible for the high-cost exception. We may modify this list periodically based on our assessment of home prices in certain localities. We recently completed an assessment and granted a high-cost exception of 165% of area median income in the New York counties of Dutchess, Orange, and Ulster. This change became effective for mortgage applications dated on or after July 25, 2003. This increased limit will

be reflected in the August 24, 2003, Desktop Underwriter release. Until the new limits are implemented in Desktop Underwriter, lenders should manually adjust the limit for Desktop Underwriter-processed mortgages.

Part IX: Special Housing Initiative Mortgages

Chapter 2, Native American Housing Initiatives, Section 202, HUD-Guaranteed Section 184 Mortgages. Under HUD's Section 184 program, HUD guarantees loans made to Native American families and Indian Housing Authorities. Previously, HUD would guarantee only loans for the purchase, construction, or rehabilitation of one- to four-family dwellings on trust lands and lands located in Native American areas. Recently, the Section 184 program was modified to permit the refinance of a mortgage that was made to a Native American family or Indian Housing Authority to lower the interest rate and/or reduce the mortgage term. Our current policy requires the mortgage transaction to be a purchase money transaction, with the proceeds used solely to acquire the property or to acquire and rehabilitate the property. Because of the program change, we will now permit eligible mortgage transactions to include refinances of mortgages as long as they comply with HUD's criteria for Section 184 mortgages.

Part X: Underwriting Guidelines

Chapter 1, Loan Application Package. *As part of our efforts to provide increased homeownership opportunities for people with disabilities,* we are expanding our underwriting guidelines as they relate to establishing a credit history and the acceptance of rental income from boarders as an eligible source of stable income. We will be providing additional information concerning sources of income for people with disabilities on our website (www.efanniema.com) in the near future. Lenders are reminded that, when delivering a mortgage to us that involves a borrower or family member with a disability, they must include Special Feature Code 325 on the *Loan Schedule* (Form 1068 or 1069) or *Schedule of Mortgages* (Form 2005).

Chapter 1, Section 103.04, Nontraditional Mortgage Credit Report; and Section 103.05, Other Alternative Credit Verifications. If a borrower does not have the types of credit that would appear on a traditional credit report, the lender may use a nontraditional mortgage credit report that is developed by a consumer reporting agency according to the requirements in Part X, Section 103.04 of the Selling Guide. We also permit the lender to develop a nontraditional credit history by using a combination of individual written credit references provided directly by the creditors per the requirements in Part X, Section 103.05 of the Selling Guide. We understand that some people with disabilities may have a court-appointed guardian or Social Security Administration (SSA) representative payee who manages their financial transactions and maintains records on their behalf, and that some credit accounts may be held jointly in the name of the person with disabilities and the court-appointed guardian or SSA representative payee. When that is the case for a borrower with disabilities and that borrower does not use the type of credit that would appear in a traditional credit report, it is acceptable for the lender to use the documentation presented by the court-appointed guardian or SSA representative payee to either request from a consumer

reporting agency a nontraditional credit report or to establish a nontraditional credit history for the borrower in accordance with the criteria presented in Part X, Section 103.05 of the Selling Guide. The lender must evaluate the credit history it obtains from the credit reporting agency or that it develops using alternative credit verifications under the same standards it uses to evaluate a traditional credit history.

Chapter 4, Salaried or Commissioned Borrower's Income, Section 401, Stability and Continuity of Income. Our policy requires a lender to confirm that a borrower has a history of receiving stable income from employment or other sources and that there is a reasonable expectation that the income will continue to be received in the foreseeable future, usually for three years. Lenders have asked us for clarification of our policy. A lender should make the determination of income stability and continuance for all sources of income based on the required documentation for the income source, as presented in Part X, Chapter 4 of the Selling Guide. Unless there is evidence that the income will no longer be received, the lender should assume that it will continue. For example, if income from alimony and child support payments is being used to qualify the borrower and the documentation (divorce decree and/or separation agreement) specifically states that these payments will cease once the child reaches 18 years of age and if the child is listed on the application as being 17 years of age, the lender could not assume that the income will continue for three years. On the other hand, when a borrower has indicated the source of income is Social Security retirement benefits and the borrower has reached 62 or 65 years of age, the lender could assume that the income will continue for three years. Additionally, there are other sources of income, such as certain types of disability benefits (for example, Social Security Disability Insurance benefits or Veterans Disability Compensation benefits, among others) that do not have defined expiration dates. For such cases, the documentation should indicate the income type. When the lender believes or knows that the income falls in a category that does not have a defined expiration date, the lender may conclude that the income is considered stable, predictable, and likely to continue and is not expected to request additional documentation from the borrower.

Chapter 4, Section 402.22, Boarder Income. For a community lending mortgage, the rental payments that a borrower receives from a relative who resides with the borrower are considered acceptable stable income if the relative has lived with (and paid rent to) the borrower for the past 12 months. We are expanding our guidelines as they relate to the acceptance of rental payments from boarders to include rental payments from a live-in aide, whether or not the individual is a relative of the borrower. This income source is acceptable for a borrower with disabilities who may be qualifying for a mortgage under either our community lending mortgage or our standard mortgage eligibility criteria and underwriting guidelines. Live-in aides typically receive room and board payments through Medicaid Waiver Funds, from which rental payments are made to the borrower. When that is the case, a lender may consider these payments as acceptable stable income in an amount up to 30% of the total gross income that is used to qualify the borrower for the mortgage. The live-in aide must present appropriate documentation to demonstrate shared residency and the payment of rental payments.

Lenders who have questions about the policy changes discussed in this Announcement should contact their Customer Account Manager.

Pamela S. Johnson
Senior Vice President

Attachment

Attachment 1
Fannie Mae InterestFirst ARM Plans
(Cash and MBS)

ARM Type	Fannie Mae Plan Number	Index	Initial Fixed Rate Interest Period for MBS ⁽¹⁾	Adjust Frequency	Per Adjust Caps (+/- %)	Maximum Life Cap (+%)	Fixed Rate Conversion	Fannie Mae Note/Rider Forms ⁽²⁾
5/1	660 (cash) and 3226 (MBS)	1-yr CMT Trsy	43-66 mos	annual	2%	5%	N/A	3531/3182
7/1	750 (cash) and 3227 (MBS)	1-yr CMT Trsy	67-90 mos	annual	5% for 1st adj, 2% after 1st adj	5%	N/A	3531/3182
10/1	1423 (cash) and 3228 (MBS)	1-yr CMT Trsy	91-150 mos	annual	5% for 1st adj, 2% after 1st adj	5%	N/A	3531/3182
5/1	2725 (cash) and 3223 (MBS)	1-yr WSJ LIBOR	43-66 mos	annual	2%	5% ⁽³⁾	N/A	3530/3187
7/1	2727 (cash) and 3224 (MBS)	1-yr WSJ LIBOR	67-90 mos	annual	5% for 1st adj, 2% after 1st adj	5%	N/A	3530/3187
10/1	2729 (cash) and 3225 (MBS)	1-yr WSJ LIBOR	91-150 mos	annual	5% for 1st adj, 2% after 1st adj	5%	N/A	3530/3187
3/1	3270 (cash) and MBS)	1-yr WSJ LIBOR	19-42 mos	annual	2%	6%	N/A	3532/3189
3/1	3271 (cash) and MBS)	1-yr CMT Trsy	19-42 mos	annual	2%	6%	N/A	3533/3111

(1) For Cash, the ranges are as follows: for the 3/1 ARM, 30-42 months; for the 5/1 ARM, 54-66 months; for the 7/1 ARM, 78-90 months; and for the 10/1 ARM, 114-126 months.

(2) Forms must be most current versions, with no modifications or nonstandard addenda or riders.

(3) Please note that Plan 2725, InterestFirst ARMs delivered for cash purchase, and Plan 3223, InterestFirst ARMs delivered for MBS issuance, have a 5% lifecap, whereas *non-InterestFirst* ARM Plan 2725 delivered for cash purchase or MBS issuance may have a 6% lifecap.

(continued)

ADDITIONAL INFORMATION FOR ALL STANDARD FANNIE MAE ARM PLANS:

1. The mortgage interest rate may never decrease to less than the ARM's Mortgage Margin, regardless of any downward interest rate cap indicated above.

[The word "never" was inserted in the preceding sentence as a correction made on August 12, 2003.]

2. There is no lifetime interest rate floor, other than the ARM's Mortgage Margin.
3. To be pooled as a standard Fannie Mae ARM plan without a special disclosure, the ARM must:
 - have a monthly payment that is due on the first day of the month;
 - have an original maturity no longer than 30 years; and
 - provide for calculation of the new interest rate by rounding the sum of the Index plus the ARM's Mortgage Margin to the nearest one-eighth of one percentage point (0.125).

If otherwise, a special disclosure will be required.

Index Terminology Legend

CMT Trsy: Treasury indexes are weekly averages, adjusted to a constant maturity.

LIBOR: London Interbank Offered Rate as published by Fannie Mae or *The Wall Street Journal*, as indicated above.