Temporary Rate Buydowns

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What is a Buydown?

Permanent Buydown

- Results in a reduced interest rate for the life of the loan
- The lower interest rate is obtained through the payment of discount points

Temporary Buydown

- Provides for a reduced interest rate for the first 1-3 years of the loan
- Temporary buydown structures can differ

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Temporary buydowns can benefit borrowers who ______________

- are receiving a substantial closing cost credit
- Would like the savings to cover the cost of improvements or furnishings
- want to ease the transition into homeownership
- are expecting a pay increase in their near future

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Temporary Buydown Plan Examples

1-0 Buydown

The borrower's interest rate is reduced by 1% for the first year

The borrower begins their full P&I payments in the second year

2-1 Buydown

The borrower's interest rate is reduced by 2% for the first year, and by 1% for the second year

The borrower begins their full payments beginning in the third year

3-2-1 Buydown

The borrower's interest rate is reduced by 3% for the first year, 2% for the second year, and by 1% in the third year

The borrower begins their full payments beginning in the fourth year

Rate reductions cannot exceed a total of 3%, and rate increases cannot exceed 1% per year

Eligibility Overview

MPF Traditional Selling Guide: 2.6.9
Fannie Mae Selling Guide: B2-1.4-04
Freddie Mac Selling Guide: 4204.3

	MPF Traditional Manual UW	MPF Traditional U/W with DU or LPA	MPF Xtra
Eligible Transaction Types	Purchase Limited Cash-Out Refi	Purchase Limited Cash-Out Refi	Purchase Limited Cash-Out Refi
Occupancy Types	Primary and Second Homes	Primary and Second Homes	Primary and Second Homes
Maximum LTV	95% for 2-1 buydowns 90% for 3-2-1 buydowns	Per DU/LPA findings	Per DU findings or FNMA manual UW guidelines
Miscellaneous	Qualifying ratios are 28%/36% The borrower must qualify at the Note rate	See FNMA or FHLMC Selling Guide The borrower must qualify at the Note rate	See the FNMA Selling Guide The borrower must qualify at the Note rate

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Calculating the Cost

The cost of a temporary buydown is equal to the borrower's total savings during the buydown period

The Cost of a 2-1 Buydown

$250,000 loan amount with a note rate of 6.875%

Year 1

4.875%

Monthly P&I

$1,323

Monthly Savings
$1,642 - $1,323 = **$319**

Buydown Interest Cost
$319 x 12 = **$3,828**

Year 2

5.875%

Monthly P&I

$1,479

Monthly Savings
$1,642 - $1,479 = **$163**

Buydown Interest Cost
$163 x 12 = **$1,956**

Years 3-30

6.875%

Monthly P&I

$1,642

Monthly Savings
$1,642 - $1,642 = **$0**

Total Buydown Cost
$3,828 + $1,956 = **$5,784**

All payments/amounts have been rounded
The note rate reflected is for illustration purposes only

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Who Pays for a Temporary Buydown?

- Seller Credit
- Builder Credit
- **Lender Credit**
- Gift funds
- **Third party organization such as a non-profit agency or the borrower's employer**

Freddie Mac *prohibits lender-funded plans on limited cash-out refinances where the funds derived from a higher interest rate*
Fannie Mae *appears to allow the use of lender funds but requires specific wording in the buydown agreement to ensure the funds are transferred in the event of a transfer of servicing*
MPF Traditional *manual underwriting: no restrictions mentioned*

Some organizations may limit how their funds can be applied/used

Interested Party Contribution Limits

	Maximum LTV/CLTV/TLTV	Maximum Contribution
Primary Residence or Second Home	Greater than 90%	**3%**
	75.01% – 90%	**6%**
	75% or less	**9%**

Who is <u>not</u> considered to be an interested party?

The borrower’s employer or lender*

***Unless they are the seller or affiliated with the seller or another interested party**

The Temporary Buydown Process

Identifying Opportunities

Alex is reviewing a sales contract and notices that the borrower is receiving a seller credit

- Make sure the credit falls within the IPC limits
- Credits can cover closing costs, buydown costs, or both
- **Best practice:** provide scenarios for spending the credit so the borrower can make an informed decision

Seller Credit Scenario

- Purchase Price: **$333,000**
- Loan amount: **$300,000**
- Note rate: **6.750%**
- The seller is providing a **3% ($9,990)** closing cost credit
- Est. closing costs: **$3,150**

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Seller Credit Scenario

The borrower would like to use the credit to cover closing costs

That leaves a seller credit balance of **$6,840**

What are the options?

6.750% = $1,946 (note rate)
5.750% = $1,751
4.750% = $1,565
3.750% = $1,389

	1-1 Buydown	2-1 Buydown	3-2-1 Buydown
Seller Credit Balance	$6,840	$6,840	$6,840
Monthly Savings: Year 1	$195	$381	$557
Monthly Savings: Year 2	N/A	$195	$381
Monthly Savings: Year 3	N/A	N/A	$195
Total Cost:	$2,340	$6,912	$13,596
Seller Credit Remaining	$4,500	-$72	-$6,756

All amounts are rounded, for illustration purposes only

Important Information about Temporary Buydowns

The promissory note and security instrument (mortgage/deed of trust) must not reference any details about the temporary buydown rate(s) and/or payment(s)

The note must reflect the original interest rate and not a reduced temporary rate

The borrower must qualify using the original interest rate reflected in the note and not a reduced rate

Fannie Mae Requirements

Fannie Mae's Selling Guide references a "buydown plan" with the following requirements:

The buydown plan must be a written agreement between the party providing the buydown funds and the borrower

- The sales contract may be considered a written agreement if it includes the amount of the seller/builder credit and how it will be used
- The appraiser and MI company (if applicable) must be provided with the plan information

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Buydown Agreements

Fannie Mae Selling Guide: B2-1.4-04
Freddie Mac Selling Guide: 4204.3

A buydown agreement must be prepared by the lender to disclose details of the buydown plan to the borrower

Examples (not all inclusive) of what may be disclosed in the agreement includes:

- Payment schedule
- Payment amounts
- Interest rate(s)
- Buydown subsidy details

- **Your organization is responsible for the agreement (discuss with your legal/compliance department)**
- **Fannie Mae and Freddie Mac have set requirements for what must be included in the agreement**

Fannie Mae Buydown Agreement Requirements

Fannie Mae requires the following information in the agreement:

- The buydown agreement must state that if for any reason the buydown funds are not available, the borrower is not relieved of the obligation to make the mortgage payments required by the terms of the note
- If the buydown is lender funded, notify the borrower that in the event servicing is subsequently transferred, the funds in the buydown account must be transferred to the new servicer
- It may be stated that the buydown fund balance may be refunded to the borrower (or to the lender if the lender funded the buydown) if the loan is paid off before all buydown funds have been applied
- A copy of the buydown agreement must be retained

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Freddie Mac Buydown Agreement Requirements

Like Fannie Mae, Freddie Mac has required buydown agreement provisions:

- The funds in the buydown account will be automatically applied each month to reduce the monthly payments of principal and interest
- Should the buydown funds not be paid, the borrower remains responsible for the full P&I payment reflected in the note (same as Fannie Mae)
- The borrower cannot assign, transfer, close the buydown account, or withdraw buydown funds except as permitted by the buydown agreement

Temporary Buydown Funds

- The funds collected for the temporary buydown must be deposited into a custodial bank account with the lender/loan servicer
- The funds cannot be mixed with the lender/servicer's other corporate funds
- The lender/servicer is responsible for remitting the full P&I payments (per the Note) to the investor
- **Funds in the custodial account are used to cover the difference between the temporary buydown P&I payment received from the borrower and the full P&I payment that is due to the investor**

You've collected the funds to cover the payment differences during the temporary buydown period

What do you do with those funds?

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Servicing Temporary Buydowns

Lenders or loan servicers remit monthly P&I payments to investors like the MPF Program, Fannie Mae or Freddie Mac

The funds collected to cover the monthly P&I shortfalls (cost of the temporary buydown) are placed in a custodial account with the lender/servicer

Each month, the lender/servicer dips into the custodial account for the amount needed to cover the difference between the borrower's reduced P&I and the actual P&I amount stated in the Note

Remember, the investor is expecting the full P&I amount

When the temporary buydown period ends, the funds in the custodial account should be depleted

The borrower starts making their full P&I payments (per the Note rate)

Use of Buydown Funds

Buydown funds are not refundable unless the mortgage is paid off before all the funds have been applied

- Funds should be credited towards the payoff or returned to the borrower (or lender) per the terms of the buydown agreement

- Buydown funds cannot be used to pay past-due amounts

- In the event of a foreclosure, the funds must be used to reduce the mortgage debt

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Temporary Buydown Knowledge Check

Which of the following statements are true?

a. **The borrower qualifies using the note rate**

b. **The buydown terms must be included on the promissory note**

c. **The cost of the buydown is always subject to interested party contribution limits**

d. **Cash-out transactions are ineligible**

a. and d. are true

- Buydown terms are never reflected in the promissory note
- If the lender, employer, or borrower provides the buydown funds they are not considered to be IPCs

Temporary Buydowns: Pros and Cons

Pros

- Lower payments for the first few years which is when borrowers tend to spend more on renovations and furnishings
- Provides a below market rate without the risks/uncertainty of an adjustable-rate mortgage
- Can be a smart way to use all or a portion of a seller/builder credit

Cons

- Lower payments are temporary and will increase
- Some borrowers may not be prepared for the payment increases (payment shock)
- Temporary buydowns aren’t available for certain loan or property types

MPF Contacts and Resources

MPF Service Center

Email - MPF-Help@FHLBC.com
Hours - 8:30 am to 4:30 pm CST
Phone: (877) 345-2673

Keep up with MPF Xtra product guideline updates by subscribing to MPF Announcements:

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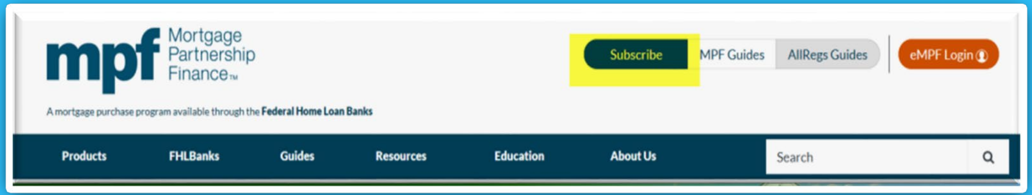

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