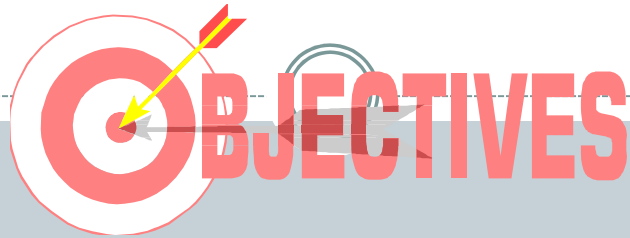


LESSON FOUR



THE SECONDARY MARKET

STUDENT LEARNING OUTCOMES (SLOs):



- 1. Define the term "secondary mortgage markets".*
- 2. Describe how the big three Government Sponsored Enterprises: Fannie Mae (FNMA), Freddie Mac, and Ginnie Mae (GNMA) function in the secondary market.*
- 3. Describe the role of investment bankers in the secondary market.*

I. WHAT IS A SECONDARY MORTGAGE MARKET?



- A. Existing loans: For the **sale and purchase** of existing loans secured against real property (first trust deeds and mortgages).
 - B. Contrast to Primary Market:
 - where loans are originated
 - Lenders loan money directly to borrowers
 - first or junior/secondary trust deeds
1. Primary lender options:
 - ✦ **Keep the loans they originate**
 - ✦ **Bundle the loans into portfolios and sell them on the Secondary Mortgage Market to investors.**

2. Primary lenders do not keep the loans they originate.



- a) Primary lenders sell the loans in the Secondary Money Market.
- b) The sale proceeds replenishes the primary lenders' loaned funds
- c) The replenished funds enables the primary lender to originate more loans



3. Loan SERVICING



Borrower & Servicer:

- a) **Collecting monthly payments:**
 - Principal
 - Interest
 - Property taxes and special assessments
 - Property insurance policies (hazard, mortgage, flood)
- b) **Operational procedures:**
 - Accounting
 - Loan analysis
 - Property inspection
 - foreclosure

Servicer & Investor:

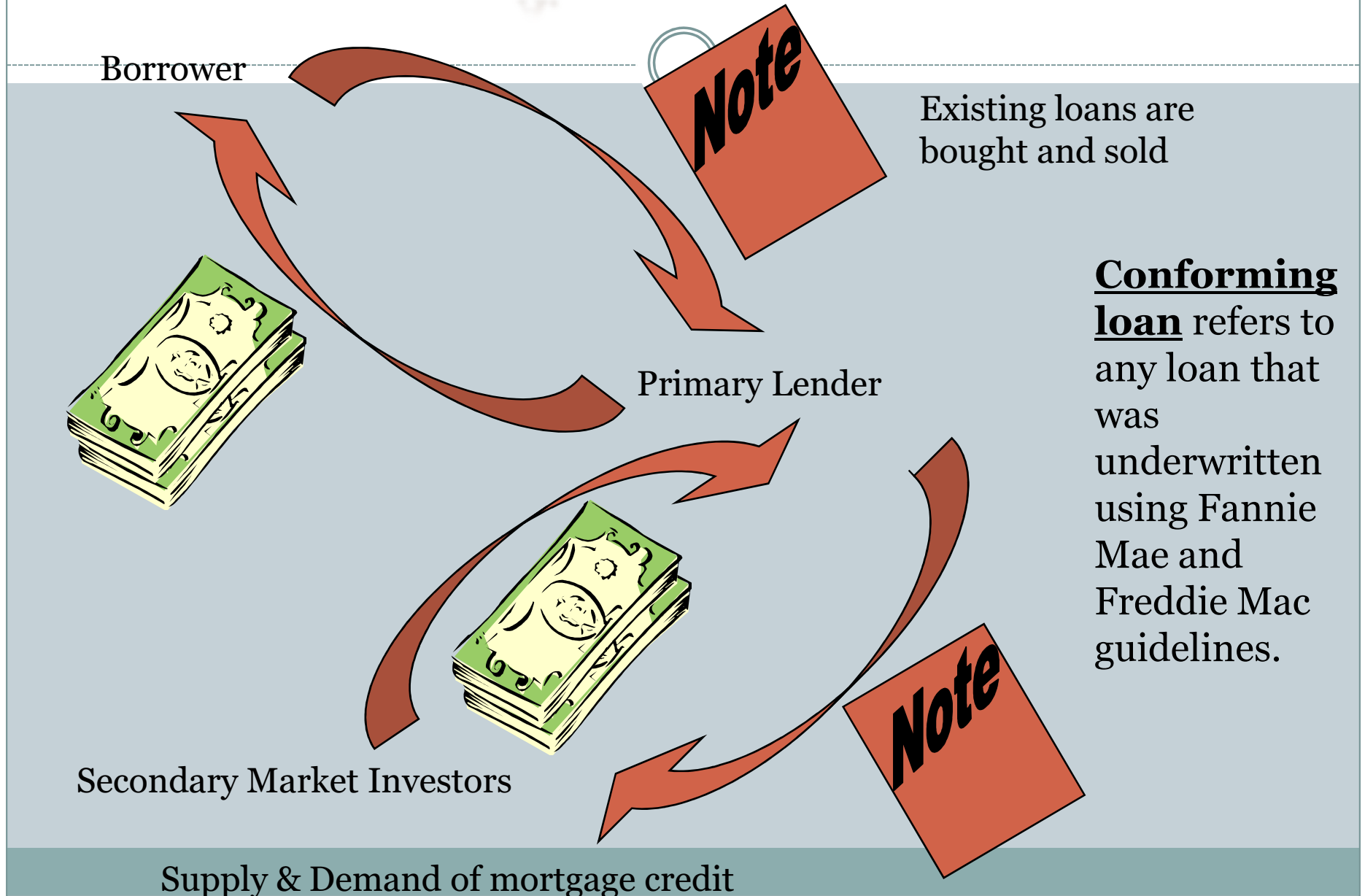
- c) **Collection FEE**

1/2 of 1% (0.050%) of outstanding loan balance included in the interest rate
- d) **Servicing agreement**

is between seller-servicer and the investor, stating the rights & obligations of both parties.

II. FUNCTIONS OF THE SECONDARY MORTGAGE MARKET

A. Flow of funds



II Functions of the Secondary Market

B. Stabilize the Money Market cycles

- tight money cycle
- loose money cycle

III. CHIEF PLAYERS

Government Sponsored

Enterprises (GSEs)

1. Fannie Mae (FNMA)
2. Ginnie Mae (GNMA)
3. Freddie Mac (FHLMC)





A. Fannie Mae (FNMA)

Federal National
Mortgage Association

FNMA:
www.fanniemae.com

- Established by Congress in 1938 to purchase existing FHA loans.
- Issues stock to general public
- Provides blended rate mortgages
- Issues mortgage-backed securities
- Today, purchases FHA/DVA/Conventional (1-4 units)

A. Fannie Mae

A. 1. SOURCES OF MONEY

a. BORROWING

- Selling short-term notes and debentures (long-term unsecured debts.)

b. GOVERNMENT ASSISTANCE

- Secretary of the Treasury is authorized to purchase securities to boost the credit standing.

c. STOCK

- A private corporation listed on the New York Stock Exchange.

FNMA



- a. Housing & Economic Recovery Act of 2008
 - 1. General Conforming loan limits
 - 2. High-Cost area conforming loan limits
- b. b. 50% higher in Hawaii, Alaska, Guam & U.S. Virgin Islands
- c. Maximums are to insure notes can be sold in bulk in the securities market
- d. Loan limits may be exceeded
 - 1. Jumbo
 - 2. Non-conforming
- e. Interest rates on jumbo loans may be ½% point above conforming.



B. Freddie Mac (FHLMC)

Federal Home

Loan Mortgage
Corporation

FHLMC:

www.freddiemac.com

- Organized:
 - In 1970 by the Emergency Home Finance Act
 - To provide secondary market for S&L loans.
- Falls under HUD oversight
 - Today purchases loans from institutions supervised by OTS and insured by an agency of the federal government
- Issues stock to general public
 - Buys and resells residential conventional mortgage loans
 - Requires loan insurance if loan over 80% of appraisal

B. Freddie Mac



- 1. Types of Loans
 - Buy FHA, DVA and conforming conventional loans
 - Security for the loans:
 - ✦ Single-family homes
 - ✦ Condominiums
 - ✦ Planned unit developments
 - ✦ FHA multi-family projects
- Loan limits
 - Subject to maximum amounts that Fannie Mae purchases



C. Ginnie Mae (GNMA)

Government National
Mortgage Association

- Guarantees securities issued by FHA-approved home mortgage lenders
- Wholly-owned corporation of the U.S. government
- **Operates under supervision of HUD**
- Created in 1968

Ginnie Mae



C. Ginnie Mae responsibilities:

1. manage and liquidate loans **acquired by the U.S. Government**
2. develop mortgage-backed security programs
3. pools of loans **guarantees the time payments of both principal and interest**
4. able to attract pension funds
5. buying stocks and bonds

a. Ginnie Mae securities benefits include:

1. Purchasers invest in mortgages without time-consuming paper work
2. The security is **guaranteed by the U.S. Government**
3. **liquid investments**

IV. FREDDIE AND FANNIE



- A. Operated as quasi-governmental agencies
- B. have maintained a call on the **Department of Treasury** funds should they need arise
- C. now require financial aid from the **U.S. Treasury**
- D. greater regulation of these two agencies
- E. tighter regulation may reduce financing for low-income housing.
- F. Retirement packages very high for the leaders/heads

IV. FREDDIE AND FANNIE



- G. HR 1427 (The Federal Housing Finance Reform Act of 2007)
- Consolidate oversight for Freddie & Fannie & Federal Home Loan Banks
 - All placed under a single regulator
- H. In 2008, placed both Freddie and Fannie under conservatorship of **Federal Housing Finance Agency (FHFA)** to:
- **prevent the collapse** of both corporations
 - **extend credit limits.**
 - grant both agencies access to Federal Reserve low interest rate loans, at similar rates to that of commercial banks.
 - allowing the Treasury Department to own stock in both agencies

V. ACCOMPLISHMENTS OF SECONDARY MARKET SOURCES



- NEW SOURCES OF **FUNDS**
- **PROVIDE FUNDS** DURING TIGHT MONEY MARKETS
- INCREASE THE FLOW OF MONEY
- **STANDARDIZATION** OF FORMS
- Awareness of Environmental Hazards