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Interest rates are low, but it's still hard to get a mortgage

Lenders' underwriting standards appear to be tightening even further in some key areas, and the time to close a loan is getting longer.

By Kenneth R. Harney

September 30, 2012

WASHINGTON — With 30-year mortgage rates hitting new lows and recent borrowers' payment performance the best by far in decades, you'd think that banks and other lenders might be loosening up on their hyper-strict underwriting standards.

But new national data from inside the industry suggest this is not happening. In fact, in some key areas, standards appear to be tightening even further, and the time needed to close a loan is getting longer.

The average FICO credit score on new loans closed in August was 750, 9 points higher than it was one year earlier, according to Ellie Mae Inc., a Pleasanton, Calif., mortgage technology firm whose software is used by many lenders. The survey sample represents about one-fifth of all new loans — roughly 2 million mortgages.

At Fannie Mae and Freddie Mac, the dominant players in the conventional mortgage market, the average FICO score was even higher. For refinancings in August, the average approved borrower had a 769 FICO score, up 6 points from August 2011. The average score for borrowers purchasing homes was 763, 1 point higher than the year before.

FICO scores are used by virtually all mortgage lenders to gauge the credit risk posed by a borrower. Scores range from 300 to 850, with low scores representing higher probability of default, high scores indicating low risk. Fair Isaac Co., developer of the FICO scoring model, says 78.5% of consumers have scores between 300 and 749. Barely 1 in 5 consumers, in other words, scores high enough to meet today's FICO score averages at Fannie and Freddie.

Other signs of how strict lenders' standards have become:

• The average purchaser of a home using a Fannie-Freddie loan made a down payment of 21% in August and had a squeaky-clean debt-to-income ratio — with total monthly debt payments, including the mortgage — amounting to just 33% of income. Refinancers had an average equity stake in their houses of 30%.

• People who were rejected for Fannie-Freddie mortgages also had seemingly solid credit profiles by historical standards. The typical buyer whose application was declined had a 734 FICO score — up 2 points from a year before — and was prepared to put down 19%.

• Federal Housing Administration borrowers' credit profiles were also impressive, especially in view of that agency's statutory mission to serve consumers with modest incomes, low down payments and less-than-perfect credit histories. In August, according to Ellie Mae's survey, the average FICO score for FHA refinancers was 717, up 11 points from the year earlier. FHA home purchasers had average scores of 700 — 4 points below what they were 12 months ago — but still far beyond historical norms. The FHA officially accepts FICOs as low as 500 and requires 10% down payments for borrowers below 580 but does little business at these score levels.

• In addition to — or maybe because of — the tougher standards, the mortgage process itself appears to be slowing down. The average time from application to closing for all loans during the time cycle in the Ellie Mae survey was 49 days, nine days longer than the previous August. For refinancings, the average processing time was 51 days, up from 37 days a year earlier.

What's going on here? Given the Federal Reserve's repeated interventions to lower the cost of money to banks, why are they keeping their credit requirements so high? Are there any prospects for relief for prospective buyers who simply don't have 20% or 30% to put down and don't have elite-bracket FICO scores?

Doug Duncan, the chief economist for Fannie Mae and former chief economist for the Mortgage Bankers Assn., has a unique perspective on all this. He readily acknowledges that big banks — and Fannie and Freddie themselves — are seeing their highest-quality "books of business" in decades, maybe ever, thanks in large part to their strict credit standards and rigorous documentation rules.

He believes, however, that the underwriting cycle could start to loosen up as banks begin to pare their post-housing-bust pricing add-ons for borrowers, their fears of costly buybacks of existing loans recede and long-awaited rules on mortgage lending are unveiled by the federal government.

That's somewhere on the horizon. But in the meantime, don't look for any dramatic relaxation. To get a mortgage, you'll generally need high scores, big down payments — except for the FHA, which accepts 3.5% down — plenty of time and reams of documentation.

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