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Wary banks revert to strict lending standards

Mortgage industry makes it harder to borrow — even for good credit risks

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WASHINGTON - Just when consumers and the U.S. economy need banks to lend more freely, the mortgage industry is making it harder to borrow — even for those with good credit.

Mortgage insurers, whose backing is required for borrowers who can't afford the traditional 20 percent down payment on a home, have already flagged nearly a quarter of the nation's ZIP codes where they refuse to insure some home loans.

That encompasses a wide variety of neighborhoods: McMansions in Scottsdale, Ariz.; luxury Miami condos; 1960 ranch houses in Flint, Mich.; and early 20th century kit homes in Metuchen, N.J.

The entire states of California, Florida, Arizona, Michigan, Ohio and Nevada — which have seen the highest foreclosure rates and the worst price declines — are blackballed on some mortgage insurers' lists.

Banks that have lost billions because of bad bets during the housing boom are now reverting to strict lending standards not seen in nearly 20 years, according to industry data and interviews with lenders.

For new home buyers and those seeking to refinance, it can mean higher down payments and a higher bar for credit scores, among other requirements. The toughest restrictions are in markets where home prices are falling, though regions where property values are rising are not immune.

"We're in the midst of an epic, broad, sweeping change in the mortgage industry," said Chris Sipe, a loan officer with America East Mortgage in Frederick, Md.

The reluctance to extend credit comes despite a flurry of government initiatives, including steady interest rate cuts by the Federal Reserve, intended to make it easier for would-be borrowers and those facing interest-rate resets on their mortgages.

Lenders' growing leeriness threatens to dampen sellers' already soggy prospects for the spring home-buying season — and that means more pain for the already battered housing sector and the broader economy.

In recent weeks, mortgage insurers have flagged more than 9,600 ZIP codes in at least 34 states where they won't insure certain types of home loans — those for investment properties or second homes, those with riskier adjustable-rate or interest-only mortgages, or for buyers making down payments of less than 3 percent.

With banks and mortgage insurers pulling back, state and federal programs for first-time buyers and people with poor credit are attempting to fill the void.

Don Brekke, an equipment operator from Colorado Springs, Colo., tried to buy a bank-owned 1950s ranch home for $113,000. At first he couldn't get a loan because the house was in a potentially declining market, and lenders required a 10 percent down payment, more than he could afford.

Ultimately, he was able to qualify for a 100 percent loan from Colorado's state financing authority, and he plans to close in the coming days.

"It was a bunch of headaches — going around and around to get this done," Brekke said.

The combination of sinking home prices and tighter lending standards has been a major aggravation for Ron Broussard, a 38-year-old sales representative for a home builder.

Broussard took advantage of soaring Southern California property prices three years ago to refinance a loan on a house he had owned since the late 1990s. Today he's still stuck with a $720,000 mortgage and has been renting it out since moving with his family to Texas a year ago. Once appraised for $1.1 million, Broussard's lender now says it's worth about $300,000 less.

He does not yet owe more than the property is worth, but Broussard worries that is a possibility.

"The way the market's going, you know, who knows?" he said.

Broussard has found little sympathy from his lender, Countrywide Financial Corp. While Broussard accepts responsibility for taking out a mortgage whose monthly payments are due to skyrocket once the unpaid principal exceeds the home's value by 15 percent, he feels betrayed by the lender's unwillingness to negotiate better terms.

The stinginess of banks is showing up in home loan statistics: The value of all new mortgages plummeted to $450 billion in the fourth quarter of 2007, down 38 percent from a year earlier, according to trade publication Inside Mortgage Finance.

Subprime loans, made to borrowers with poor credit, virtually disappeared from the market, plummeting 90 percent to $13.5 billion in the October-December quarter.

There is a silver lining: The Federal Reserve has repeatedly cut interest rates, helping borrowers whose mortgages were just about to reset to higher rates and people with student loans. Reflecting the Fed's efforts, rates on 30-year mortgages dropped below 6 percent this week for the first time in more than a month.

But the long-term impact of the Fed's move is far from certain, and the central bank's actions could end up feeding inflation and pushing up long-term rates.

"The credit crunch is much like the movie villain that refuses to die," said Greg McBride, a senior financial analyst at Bankrate.com. "The effects are spilling out, far beyond what was originally seen."

Amid the turmoil, the mortgage industry is playing hardball with borrowers.

Wells Fargo & Co. now requires a 25 percent down payment in the most distressed markets, according to a document sent to mortgage brokers last month. A company spokesman said in an e-mail message that Wells Fargo is "focused, as we've always been, on fair and responsible lending and sound credit risk management."

Some borrowers who took out home-equity loans or second mortgages are being blocked from refinancing. The problem is most common among consumers using two different lenders.

Companies that made second mortgages are now denying requests — common in a refinancing transaction — to take secondary status in the event of a foreclosure. Especially in markets where prices are declining, holders of those loans want to be paid off before a loan is refinanced rather than take on the risk of default, industry experts say.

Lenders' changes have removed 30 to 40 percent of the borrowers who could have qualified in recent years, estimated Tom LaMalfa, managing director at Wholesale Access, a Columbia, Md.-based mortgage research firm.

Lenders and mortgage insurers are also requiring proof of income and employment, something they didn't always do during the housing boom.

"It's no longer people buying pools of loans, strictly written by a computer, and no one knowing what's in a pool," said Marc Schwaber, chief executive of Preferred Empire Mortgage Co. in New York. "The loan is going to have to make sense."

Many in the real estate industry hope that the economic stimulus legislation signed by President Bush earlier this year allowing Fannie and Freddie to back loans larger than their former limit of $417,000 will kick-start the housing market.

And while this week's interest rate cut by the Federal Reserve could tempt banks to lend more, experts say they are likely to remain skittish for months to come.

"It's going to take time for banks to tiptoe back into the water," said Jefferson Harralson, a banking industry analyst with Keefe, Bruyette & Woods Inc.

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