Smoke and Mirrors: Despite Govt Rhetoric, Risky Home Mortgages Are Readily Available

January 28, 2014 - After the 2007 collapse in housing prices you might think that both the government and mortgage lenders would be a little gun-shy when it comes to issuing new mortgages to people with limited assets. And if you listen to the news, you might think that new government regulations just put into effect by the CFPB with regard to "qualified mortgages" would forever end some of the lending practices that led to the Great Recession. But a closer look at what is actually happening in mortgage markets leads to another conclusion entirely. Risky mortgages are still very much available to borrowers if you know where to look. And as before, any costs associated with a future failure of those loans will be borne by taxpayers.

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Much fanfare was given to the CFPB's new qualified mortgage rules that went into effect earlier this month. The rules have been ballyhooed by politicians and the CFPB alike as a method to end risky lending practices by banks. The goal of those rules is make sure that borrowers have the ability to repay loans in their entirety.

But the new rules have a big loophole in them. State-run Housing Finance Agencies (HFAs) are exempt. And many states are now all too happy to provide their residents with loans that can't get by going direct to a bank. Furthermore, HFAs are targeting higher risk borrowers. Those with limited assets and income or lower credit scores. They are not however targeting sub-prime borrowers.

HFAs can provide loans to prospective homebuyers who put as little as 3% down on the property they are purchasing. They are then selling off these loans to Fannie Mae, Freddie Mac and others who in turn are carving the loans up into

securities and reselling them to investors. If this sounds all too familiar, that's because it is precisely what happened from 2000 to late mid-2007, and which led to the collapse in real estate prices nationally.

To make matters worse, even though private lenders are now barred from issuing the types of loans issued through HFAs directly to consumers, private lenders can make loans through the HFAs. This means that the states are now enabling the very same type of lending and investment practices that caused the most recent downturn.

Currently, the number of loans being issued by HFAs is relatively low but it is growing. And to date, they do appear to have low default ratesâ€¦ around 3%. But since housing prices are now on the rise, the risk of borrowers defaulting is likely to remain low for the next few years. Right up until the next inevitable downturn in housing prices. When that happens, loan defaults and foreclosures will increase. And if HFAs continue to make loans to borrowers who have little equity in their properties and lower credit scores, then the risk to taxpayers will only increase over time.
All HFA loans are federally guaranteed.

byJim Malmberg
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