The Good Old Days of Mortgage Lending Are Back! What Could Possibly Go Wrong?

October 22, 2014 - Ah, the good old days! Remember when all you needed to get a home mortgage was the ability to breathe? Well, if the Federal Housing Finance Authority (FHFA) has its way, those days may soon be back. The agency has announced that it will be loosening lending standards very soon. And the new looser standards will be specifically targeted to attract new buyers who have had prior credit issues. Better yet, the new standards will also give the banks making these loans some very clear guidelines about what they need to do to insure that they won't be forced to repurchase these loans when borrowers default! But that's not even the best part! That's reserved for the fact that the new standards will be rolled out on federally insured loans; leaving taxpayers squarely on the hook for any losses! Doesn't anyone remember the housing crash in 2008 and what caused it?

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Simply put, what FHFA is proposing is nothing short of lunacy. Although few details have been release so far, what has come to light almost guarantees that the United States will go through another housing crash sometime in the future.

The details that are known include allowing borrowers to put in as little as 3% for their down payment. Given the fact that some states have programs in place to help homebuyers with their down payment, this clause will almost certainly lead to many people being able to purchase a home with nothing down. There are also a variety of federal mortgage assistance programs which are likely to allow for zero down payment under the new lending rules. History has shown that home buyers who have little to nothing invested in their property are more likely to default when they hit economic bumps in the road.

FHFA is also planning on easing the credit standard for borrowers with prior histories of credit issues. Specifics are not available yet on what this will mean, but it is conceivable that mortgages will be offered to people with credit scores below the current 680 requirement. Another proposal that was recently floated in congress is to allow lenders to base their lending decisions on the past four years of credit history as opposed to the current seven year standard. Another proposal would allow lenders to ignore a certain number of late or missed payments over the course of the borrower's credit history.

Banks are also going to get some encouragement to make new loans when the new standards are rolled out. FHFA is insuring this by giving the banks guidelines that they can use when making their loans. These new guidelines are not what you might expect however. They are not being given to insure that the banks do a good job of assessing the risk associated with an individual borrower. Just the opposite, in fact. They are going to tell the banks what they have to doâ€¦ meaning, what minimum standards borrowers have to meetâ€¦ to insure that they don't have to repurchase loans sold off to Fannie Mae and Freddie Mac when the borrower defaults.

This morning, RealtorMag reported that FHFA Director Mel Watt "said on Monday that Fannie and Freddie would not force repurchases from lenders of mortgages that are later found to have minor flaws in them, as long as borrowers have kept up with their mortgage payments for 36 months. Watt also said that lenders wouldn't be forced to buy back bad loans if flaws were later discovered in the reporting of borrowers' finances, debt loads, and down payments â€" as long as the borrowers would have qualified for the loans had the information been accurate."

This kind of a loose standard is likely to lead to a return of banks working with mortgage brokers. In fact, it may provide an incentive to bank to work with brokers and to reduce the size of their in-house lending programs. That's because the banks will once again be able to blame brokers for any poor lending decisions that they make. Again, this is reminiscent of the 2008 housing crash and its aftermath.

Sadly, the FHFA proposal will do almost nothing to ease lending standards for those with better credit. Lending standards within this group of borrowers, often those who are self-employed, remain high.
byJim Malmberg
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