Expanding the Box of Opportunity

Lowering the credit bar for jumbo mortgages can unlock the American dream for many

By Matthew J. Tomiak

Spend enough time in the housing market, and you will see plenty of ups and downs. In the wake of the financial crisis some 10 years ago, lenders shut their doors to homebuyers, other than those with the very best credit profiles.

Since that time, the pendulum has begun to swing back to a more normal and rational lending environment, with credit standards for mortgages starting to loosen up. The environment is still not at an optimal level, however, considering the many potential homebuyers who deserve the American dream but cannot seem to realize it.

In the wake of the housing crisis, Ginnie Mae, Fannie Mae and Freddie Mac, under the guidance of the Federal Housing Finance Agency (FHFA), were the first to begin expansion of acceptable credit profiles for mortgage loans. The private jumbo-mortgage market, however, has lagged severely behind in the return to a more rational expansion of acceptable credit profiles.

Tight-credit woes

Although lenders have been expanding their credit criteria incrementally, recent statistics indicate that average credit scores for new jumbo-loan borrowers are rising. There also is growing evidence that many consumers with less-than-stellar credit scores are simply not applying for mortgages.

Despite some recent expansion driven by the FHFA, mortgage credit remains at historically tight levels. In fact, credit availability decreased this past June and again this past August, according to the Mortgage Bankers Association's Mortgage Credit Availability Index. CoreLogic recently reflected in its Housing Credit Index that significantly fewer people with FICO credit scores in the mid-600s are applying for mortgage loans as compared to earlier decades. In 2005, roughly 25 percent of applicants had FICO scores of 640 or less, but by 2015 that number had dropped to 5 percent.

These conditions have a particular impact on millennial consumers (individuals in their 20s and early 30s), who remain an underrepresented segment of the American homeownership market. An analysis of recent census data by the Pew Research Center indicates more adult children live at home with their parents now than during any other period in U.S. history.

While they might be able to afford a mortgage payment, many millennials, understandably, have shorter employment histories, shorter credit histories, less savings for a downpayment and higher debt-to-income ratios (often due to student-loan burdens). Many such borrowers live in metropolitan areas, which often require jumbo loans to buy a home.

As a result, many millennials are being left out of the homeownership market. In fact, many do not even try. After years of being turned down or reading that getting a mortgage loan is just not possible, it's not unusual for potential first-time homebuyers to self-select themselves out of the market.

It doesn't help that many mortgage originators suffer from the same preconceptions. The concern of many originators is that there is no secondary mortgage market for loans that are not "super prime" and that interest rates for loans outside that stellar-credit box make them undesirable or impractical for consumers.

Creditworthy borrowers

The truth is many consumers are needlessly missing the chance to take advantage of historically low interest rates, and mortgage originators are missing out on significant revenue opportunities. Sources of liquidity and a secondary market for borrowers with less-than-perfect credit are available.

Credit can be thoughtfully expanded in the jumbo sector to the many creditworthy borrowers currently not being served by today's market. In fact, there are already some

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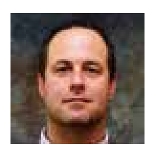

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expanded-credit jumbo-mortgage purchase programs that exist with both Qualified Mortgage and Non-Qualified Mortgage components.

These products allow FICO scores down to 661, loan-to-value ratios up to 90 percent, debt-to-income ratios up to 49.9 percent and various other financing features — such as financing for non-warrantable condominiums and condotels. These jumbo products are backed by diligent reviews from licensed underwriters and include criteria that make it simple for loan originators to understand and convey to their customers what is needed to qualify.

It bears mentioning that these newer less-than-super-prime jumbo products are very different from the stated-document and no-document loans that were offered in the years leading up to the financial crisis. These are full-document programs that take into account a borrower's entire credit profile, giving secondary-mortgage market participants the ability to truly understand and price risk.

Lack of awareness

Today's home appraisers are better trained than ever, and new criteria in the appraisal process have successfully reduced potential conflicts of interest. This provides secondary-market participants with additional confidence when purchasing mortgage loans with higher loan-to-value ratios. Because they are full-doc loans, investors in instruments backed by these expanded-rate products are able to confidently price them as prime, thereby providing competitive pricing to mortgage originators — allowing them to provide the same benefit, in turn, to their customers.

It is true that interest rates can be higher in expanded-credit jumbo programs compared with "super prime" mortgage loans with sub-70 percent loan-to-value ratios, borrower FICO scores in the 800s and other extremely low-risk credit attributes. These expanded-credit prime loans, however, are still available at historically low rates. More importantly, they offer great opportunities for individuals who are trying to avoid the increasing costs of renting, or who remain in pre-crisis, higher interest rate loans that they don't realize can be refinanced, or who are staying in a property that is not right for their current family or life situation.

So what is holding the industry back from taking greater advantage of these opportunities? To a large extent, it's simply a lack of awareness. As a result, it's important to get the word out to the loan-originator and real estate communities, who in turn can inform borrowers — especially millennials — that homeownership may be within reach after all.

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There is a good reason why the market pendulum swung toward conservative lending in the wake of the past housing crisis. By the same token, significant opportunities await mortgage professionals who are willing to reconsider current notions about today's prime credit box.

Mortgage originators should continue to drive the return to rational lending standards, because there are players in the secondary market waiting to support those efforts, just as there are borrowers who stand to benefit from them. ■