

Fallout from mortgage mess

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WASHINGTON — The mortgage credit crunch not only is affecting interest rates that homebuyers are quoted but is triggering changes in less-visible areas such as minimum credit scores, geographic location and type of properties, even controls on who orders credit reports.

These restrictions are magnifying the importance of factors such as FICO credit scores and fueling lawsuits against major creditors such as American Express and Citibank.

Here's a quick overview of what's happening:

Though recent run-ups in rate quotes for jumbo mortgages — those over \$417,000 — have received widespread publicity, subtler underwriting changes by lenders have not. Yet some of these could actually have wider implications.

For example, a traditional cutoff point between prime and subprime loans — 620 FICO scores — has migrated upward in recent weeks. Some mortgage companies are posting 680 FICOS as the new demarcation line; others have set the break point slightly below.

Webster Bank, a wholesale lender based in Connecticut, told its broker network Aug. 7 that its "minimum credit score has been increased to 680," even with full documentation of applicants' income and assets.

"I think the days of 620 [FICOs] are about over" for nonconforming mortgages that are not being originated for sale to Federal National Mortgage Association or Federal Home Loan Mortgage Corp., said Bob Armbruster, CEO of Armbruster Mortgage Services. "Investors are just too afraid to take the risk anymore."

Mark Teteris, chairman and CEO of Lakeland Mortgage in Bloomington, Minn., said "we see this every day now — investor e-mails telling us the minimum FICO for certain loans we want to see is 700" — or higher for low-doc applications.

Other lenders have bumped up minimum scores for fully documented new loans more modestly — from 620 to 640, while still others are requiring 720 FICOS as the minimum needed for any sort of limited-documentation applications.

The upward squeeze on FICOS is putting a new premium on raising homebuyers' numbers and obtaining correct scores, based on full reporting of credit data, say mortgage and credit-market experts. It's also triggering suits against some lenders and card companies over their credit-reporting practices.

In a class action filed July 25 in the U.S. District Court for the Southern District of Florida, plaintiffs charged that American Express and Citibank are depressing large numbers of clients' scores by withholding credit account limits from Equifax, Experian and TransUnion, the three dominant credit bureaus. Without credit limits or account maximums, say the plaintiffs, FICO software often penalizes the borrower by reducing scores.

Neither card company would comment on the specifics of the litigation. However, American Express said its green and gold card holders do not have "pre-set spending limits" and therefore there is no credit limit to report. Spokeswoman Molly Faust also said the latest FICO model "differentiates between charge cards and credit cards," and FICO scores are not artificially depressed.

A Citibank spokesman, Samuel Wang, confirmed that "certain cards" come with no pre-set limits and therefore limits cannot be reported to the bureaus.

Besides FICO scores, other key underwriting factors under pressure include:

- Loan-to-value ratios (LTVs) and combined loan-to-value ratios (CLTVs). Some lenders are abandoning zero-down programs, and others are requiring 10 percent minimum equity stakes. Some are restricting maximum CLTVs to 80 percent or 85 percent, where a second mortgage or credit line is proposed on a home that already has a first mortgage.
- Financial reserves. Rather than a minimum of two months' worth of loan payments verified as on deposit in a bank, some lenders now want to see six months for certain loan categories.
- Restrictions on credit reports and appraisals. One lender says it will look only at credit reports it has ordered from its own vendors — presumably an anti-fraud measure. Another wants only the freshest "comparables" for appraisals backing loan requests — properties sold within the last three to six months only, plus detailed information on asking prices of similar houses currently for sale.
- Restrictions on geographic locations and minimum loan sizes. Carl Delmont, CEO of Freedmont Mortgage in Hunt Valley, Md., says "we're beginning to see tightening [on lending] in areas where delinquency rates are high," as well as growing unwillingness to fund smaller mortgages, generally under \$100,000.

Could the unfolding credit crunch create updated forms of quasi-redlining by lenders — where whole categories of borrowers, loan types, credit profiles and geographic locations suddenly are shunned or priced out of reach?

Could second homes, nonowner-occupied properties, high-rise condos, central-city row houses — or people with minimal bank reserves, depressed FICO scores or the wrong ZIP code — face rougher times in the mortgage meat grinder?

Could be.