Harney: Subprime backlash will hurt many 'prime' borrowers

By Kenneth Harney
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WASHINGTON - Call it the credit risk hangover following the housing boom binge: Home buyers and refinancers who can't come up with sizable down payments, and whose FICO credit scores are below 680, are about to get squeezed in the mortgage market.

Giant investors Fannie Mae and Freddie Mac are imposing significant increases in fees for a broad range of borrowers who have lower than 30 percent down payments and formerly were treated as "prime" credit applicants. At the same time, the two largest private mortgage insurers - MGIC and PMI Group - are raising premiums on consumers who have low down payments and FICO scores in the mid to upper 600s. The added costs for some potential home buyers could mount into the thousands of dollars - either upfront at settlement or in the form of higher interest rates.

Each of the companies says it has experienced unexpectedly high losses on loans with these characteristics and must now revise prices upward to handle the elevated risks. But some mortgage bankers and brokers say the higher costs and down payments will make home ownership impossible or very difficult for a large number of borrowers, and slow any future housing market recovery.

Though Fannie Mae's and Freddie Mac's revised fees won't take effect until March 1, major lenders who sell loans to the two investors began imposing the surcharges on applicants at the beginning of December. Some mortgage loan officers are upset that clients with FICO scores close to 700 - far above the once-traditional 620 cutoff point between "prime" and "subprime" - are now being charged more.

"This is outrageous," said Steven Moore, a mortgage broker with 1st Solution Mortgage in Falls Church, Va. "On a loan of $300,000 and with a credit score of 675 - which is not a bad score - and a 75 percent loan-to-value ratio (25 percent down payment), the cost is an additional $2,250 per loan." If the same borrower wants to do a cash-out refinancing to consolidate debt, the new Fannie-Freddie fee schedule will add another $1,500 to total costs on a $300,000 mortgage, said Moore. On a $400,000 loan, he estimates the extra fees would total $5,000.

Jeff Lipes, president of Family Choice Mortgage in Wethersfield, Conn., said the new emphasis on higher FICO scores and larger down payments could greatly complicate rate quotations. "To get any sort of quote, you're going to need to know your FICO score in advance, and before actually applying you may need to take some steps to raise your FICO score."

Under previous standards, applicants with scores comfortably above 620 "could reasonably assume" they would qualify for a good rate, said Lipes. "But now we've got this whole new gray area between 620 and 680" FICOs under the revised Fannie/Freddie risk-based pricing guidelines. Joint applicants where one spouse or partner has a FICO score below the new guidelines will need to take special care, according to Lipes, so as not to trigger higher credit-risk fees.

Lipes predicts loan officers and brokers will make far greater use of so-called "rapid rescoring" services offered by some local credit bureaus to increase applicants' scores legally by correcting errors, lowering debt utilization ratios on credit card accounts and other techniques.

Here's a quick overview of the new policies from Fannie and Freddie affecting loan applications where the down payment amount is less than 30 percent: If the borrower's credit score is less than 620, a new 2 percent fee will be imposed. If the score is between 620 and 639, the surcharge will be 1.75 percent. If it is between 640 and 659, the add-on will be 1.25 percent. On scores between 660 and 679, the surcharge will be 0.75 percent.

According to mortgage banker Lipes, if applicants choose to roll the higher fees into the interest rate on the mortgage, the new Fannie/Freddie charges generally will increase rates by anywhere from one-eighth to one-half of 1 percent.

The MGIC mortgage insurance premium increases, which were scheduled for announcement the first week of December, are expected to have the heaviest impacts on borrowers making down payments of less than 3 percent and whose FICO scores are below 660, according to company officials. On such loans, MGIC is expected to raise premiums to 1.7 percent per $100,000 of loan amount, up from the current premium level of 0.96 percent. On a $200,000 mortgage, that would raise the annual premiums from $1,920 to $3,400.

The PMI Group's increased premium levels, which have already taken effect, are roughly similar, but the company also announced that it will no longer insure any mortgages where the down payment is less than 5 percent and the borrower's FICO score is below 620.

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