Will Lending Standoff End?

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From President Obama to Federal Reserve Chairman Ben Bernanke to Fed Gov. Elizabeth Duke, many influential policymakers believe that housing will not fully recover until banks start loosening their lending standards.Banks, though, remain reluctant to do so, fearing additional defaults-as well as more hits to their reputations. Now the

Obama administration is trying to end the standoff.

The Federal Housing Administration and the Department of Housing and Urban Development are working on a plan that would potentially release banks and lenders from liability for minor defects on FHA loans that meet current guidelines even if they ultimately default, sources say.

The plan, which was first reported by The Washington Post, sounds similar to a framework the FHFA unveiled in September to help alleviate mortgage lenders' concerns about exposure to bad loans.

For months now, HUD secretary Shaun Donovan and FHA commissioner Carol Galante have talked publicly about the need for banks and lenders to expand the so-called credit box without fear of being investigated by HUD's Office of Inspector General or being sued by the Department of Justice.

In a speech last month, Galante urged lenders to raise their minimum credit score requirements, saying they are restricting many good borrowers from getting home loans. The FHA's largest lenders, including Wells Fargo and JPMorgan Chase, have set higher minimum FICO scores of 640, even though the agency's threshold is 580-and can go as low as 500.

"We need to work together with lenders to address the difficulties created by credit overlays that restrict otherwise reliable borrowers from obtaining FHA-insured loans," Galante said. "We're working very closely to develop clear and transparent standards on indemnification for poorly or fraudulently written loans, so that lenders will not feel they need to overcorrect."

"We want to establish both a process, time frames and materiality standards that will give everyone more certainty," she said. "The obligation that I have is to ensure that lenders were using the FHA program are lending to as full a spectrum of the credit box as possible."

HUD and the FHA otherwise declined to comment.

Several lenders said they would have to wait until formal guidance was released to determine its impact.

Tom Goyda, a spokesman for Wells, the largest FHA lender, said Wells constantly reviews its policies and practices to ensure "access to responsible credit."

"We must also balance that goal with an equally important commitment to ensure that borrowers have the ability to repay their loans, and must maintain credit policies designed to ensure that the credit performance of our FHA loans, over time, is acceptable to FHA and the FHA insurance fund," he wrote in an email.

Amy Bonitatibus, a JPMorgan Chase spokeswoman, said the bank regularly reviews its "lending standards to help families buy homes they can afford over the long term."

The push to extend more loans to borrowers with weak credit comes at a time when the FHA faces a projected $16.3 billion shortfall due to massive defaults on loans made at the height of the financial crisis. To avoid a bailout from the Treasury, FHA has proposed a series of changes to shore up its finances, including increasing downpayments to 5% from the current 3.5% for jumbo loans above $625,000, and raising annual mortgage insurance premiums by 10 basis points.

Rising home prices may be driving the push to extend credit to a wider swath of borrowers.But Mark Calabria, director of financial regulation studies at the Cato Institute, said it was hypocritical of the FHA to suggest lenders suddenly loosen underwriting standards because it's those standards that shielded the FHA from even bigger losses. "The only way FHA avoids a massive bailout is if they maintain the credit quality they have today," Calabria said.

Clint Rockwell, an attorney at Buckley-Sandler, said HUD has been pushing lenders to do more manual underwriting in an effort not to exclude borrowers with low FICO scores.

"Unless there is some tangible legal protection of some kind, I don't think there's going to be much of a change," Rockwell says.

Several lenders faulted HUD's Neighborhood Watch program, an internal yardstick that compares lenders based on defaults by geographical areas. "Lenders are encouraged to make loans that don't default, which is a good objective, but is contrary to the rhetoric about expanding lending to lower-FICO-score borrowers," Rockwell said.

David Stevens, the president and CEO of the Mortgage Bankers Association, and a former FHA commissioner, said credit standards have been too tight for too long and, with housing prices rebounding, there needs to be a shift. "This is not about ever going back to the ridiculously loose lax credit standards of the early 2000s with 'no doc' loans," he said. "But we have to question whether the fear of making a bad loan, out of fear of repurchase risk, is so extreme that it may be cutting out borrowers who may be qualified on the margin to get a mortgage."