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Fannie Mae Eases Credit To Aid Mortgage Lending

By STEVEN A. HOLMES

In a move that could help increase home ownership rates among minorities and low-income consumers, the Fannie Mae Corporation is easing the credit requirements on loans that it will purchase from banks and other lenders.

The action, which will begin as a pilot program involving 24 banks in 15 markets -- including the New York metropolitan region -- will encourage those banks to extend home mortgages to individuals whose credit is generally not good enough to qualify for conventional loans. Fannie Mae officials say they hope to make it a nationwide program by next spring.

Fannie Mae, the nation's biggest underwriter of home mortgages, has been under increasing pressure from the Clinton Administration to expand mortgage loans among low and moderate income people and felt pressure from stock holders to maintain its phenomenal growth in profits.

In addition, banks, thrift institutions and mortgage companies have been pressing Fannie Mae to help them make more loans to so-called subprime borrowers. These borrowers whose incomes, credit ratings and savings are not good enough to qualify for conventional loans, can only get loans from finance companies that charge much higher interest rates -- anywhere from three to four percentage points higher than conventional loans.

"Fannie Mae has expanded home ownership for millions of families in the 1990's by reducing down payment requirements," said Franklin D. Raines, Fannie Mae's chairman and chief executive officer. "Yet there remain too many borrowers whose credit is just a notch below what our underwriting has required who have been relegated to paying significantly higher mortgage rates in the so-called subprime market."

Demographic information on these borrowers is sketchy. But at least one study indicates that 18 percent of the loans in the subprime market went to black borrowers, compared to 5 per cent of loans in the conventional loan market.

In moving, even tentatively, into this new area of lending, Fannie Mae is taking on significantly more risk, which may not pose any difficulties during flush economic times. But the government-subsidized corporation may run into trouble in an economic downturn, prompting a government rescue similar to that of the savings and loan industry in the 1980's.

"From the perspective of many people, including me, this is another thrift industry growing up around us," said Peter Wallison a resident fellow at the American Enterprise Institute. "If they fail, the government will have to step up and bail them out the way it stepped up and bailed out the thrift industry."

Under Fannie Mae's pilot program, consumers who qualify can secure a mortgage with an interest rate one percentage point above that of a conventional, 30-year fixed rate mortgage of less than \$240,000 -- a rate that currently averages about 7.76 per cent. If the borrower makes his or her monthly payments on time for two years, the one percentage point premium is dropped.

Fannie Mae, the nation's biggest underwriter of home mortgages, does not lend money directly to consumers. Instead, it purchases loans that banks make on what is called the secondary market. By expanding the type of loans that it will buy, Fannie Mae is hoping to spur banks to make more loans to people with less-than-stellar credit ratings.

Fannie Mae officials stress that the new mortgages will be extended to all potential borrowers who can qualify for a mortgage. But they add that the move is intended in part to increase the number of minority and low income home owners who tend to have worse credit ratings than non-Hispanic whites.

Home ownership has, in fact, exploded among minorities during the economic boom of the 1990's. The number of mortgages extended to Hispanic applicants jumped by 87.2 per cent from 1993 to 1998, according to Harvard University's Joint Center for Housing Studies. During that same period the number of African Americans who got mortgages to buy a home increased by 71.9 per cent and the number of Asian Americans by 46.3 per cent.

In contrast, the number of non-Hispanic whites who received loans for homes increased by 31.2 per cent.

Despite these gains, home ownership rates for minorities continue to lag behind non-Hispanic whites, in part because blacks and Hispanics in particular tend to have on average worse credit ratings.

In July, the Department of Housing and Urban Development proposed that by the year 2001, 50 percent of Fannie Mae's and Freddie Mac's portfolio be made up of loans to low and moderate-income borrowers. Last year, 44 percent of the loans Fannie Mae purchased were from these groups.

The change in policy also comes at the same time that HUD is investigating allegations of racial discrimination in the automated underwriting systems used by Fannie Mae and Freddie Mac to determine the credit-worthiness of credit applicants.