washingtonpost.com

Freddie Mac Easing Rules For So-So Credit

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Saturday, November 17, 2001; Page H01

Hundreds of thousands of home buyers and refinancers with imperfect credit could be the beneficiaries of forthcoming policy changes by the country's second-largest source of mortgage money.

Freddie Mac, a congressionally chartered private company that buys billions of dollars' worth of home loans per month, plans to extend its lowest pricing on mortgage interest rates to a wider spectrum of people who have blemishes on their credit histories.

The effect of the change would be to make lower interest rates and fees available to about 250,000 additional loan applicants annually over the next four years. The savings for qualified buyers could run into the thousands of dollars per mortgage.

Freddie Mac officials confirmed last week that the company would revise its Loan Prospector electronic underwriting system before the end of November to accept at standard interest-rate pricing large numbers of additional applicants who would now be treated as marginal and charged higher rates and fees.

Freddie Mac's electronic underwriting system allows lenders nationwide to submit borrowers' applications for advance screening online and get almost instantaneous decisions. An "accept" or "accept-plus" decision tells a loan officer that Freddie Mac would buy the closed mortgage at its best currently posted rates and terms.

A "caution" decision, on the other hand, tells the lender that Freddie sees the borrower as higher risk -- requiring a higher interest rate or extra fees on the loan -- or a re-submission after the borrower's credit profile has been improved.

The rate and fee differentials between "accepts" and "cautions" run from a quarter-percentage point to more than one percentage point. In a 7 percent market, for example, an application that gets an "accept" decision might get a 7 percent rate, but a "caution" could get an 8 percent effective rate including fees.

The Loan Prospector system at present "accepts" about 75 percent of the loans it evaluates. Under the planned revisions, that figure would increase to 80 percent. The additional 5 percentage points -- about 1 million applicants over four years -- would be qualified for the standard rates.

Patricia McClung, Freddie Mac's vice president in charge of the Loan Prospector system, said the new, more liberal pricing is the product of technological "enhancements" in the company's ability to distinguish moderate-risk borrowers from higher-risk borrowers.

The Loan Prospector system incorporates credit, appraisal and other underwriting criteria to determine whether an application is acceptable for purchase. Though most of the loans Freddie Mac buys are high-quality "conforming" mortgages under $275,000, it does buy some loans with blemished credit, high debt ratios and tiny down payments.

All three of those characteristics increase the statistical likelihood that a borrower would default. When combined, they require extra-careful scrutiny and possibly higher rates and fees. Loans with down payments of less than 20 percent require private mortgage insurance -- paid for by the borrower -- to qualify for funding by Freddie Mac.

Competitor Fannie Mae, which uses its own computerized loan screening system, has similar requirements for what loans it would buy.

Loans to people with credit file "dents and nicks" -- two or three late payments on credit cards, auto loans or other debts -- also generally are offered with higher rates or fees. But under its revised program, Freddie Mac is essentially saying: Even in a recession, we know that many borrowers who look risky would turn out to make their loan payments on time every month. Sure, they may have had temporary difficulties and a missed a payment or two, and they may be strapped with a lot of personal debt. But that's not unusual these days, and we know from our research that many of these folks are going to be rock-solid, dependable customers.

"We feel we now know which 'dents' and 'dings' really matter" and "how to weight them" in forecasting future risks of nonpayment, said a Freddie Mac official. The company's new approach is another in a series of steps since the late 1990s to widen the "accept" entryway and reduce costs for marginal borrowers. The higher the rate of "accepts" through its online underwriting system, the smaller the number of home buyers who are forced to deal with "sub-prime" or nonconforming mortgage money sources.

The latest changes are expected to be especially important for first-time and modest-income applicants who may have below-average credit scores and high household debt ratios. A Freddie Mac official said the estimated million additional "accepts" expected in the next four years may not all translate into actual loans bought by the corporation.

The upshot of all this for you? First and foremost, if you fit the profile, be aware of this potential opportunity to save money on mortgage rates and fees. Don't be shy about it with lenders, either. Ask whether they use Loan Prospector and whether they think you might be the sort of borrower the changes might help most.

And then go for it.

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