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Low Rates for Just a Few

By **BOB TEDESCHI**

MORTGAGE borrowers might be forgiven for sometimes feeling like victims of a bait-and-switch scheme.

For the last year or so, news has been trumpeted about historically low interest rates on 30-year fixed-rate loans; the rates tilted near 4.5 percent late last year and are now hovering above 5 percent. But when a borrower calls a mortgage broker to secure such a rate, he or she often fails.

That's because many borrowers have a credit score below what is considered "prime," according to [Experian](#), one of the major credit-reporting agencies. On a scale of 501 to 990, Experian puts the average score at 771. (FICO, which developed the most widely used scores for assessing credit risk, doesn't publish an average figure but says the median credit score is 720, on a scale of 300 to 850.)

And under current guidelines from Freddie Mac and Fannie Mae, the government agencies that set lending standards for most mortgages sold in the United States, only those borrowers with [credit scores](#) of 740 or more, and a down payment of at least 20 percent, can avoid extra loan charges that could effectively raise the mortgage rate.

Borrowers with credit scores of 700 to 740 typically face additional charges of one-quarter to three-quarters of a percentage point of the loan amount. On a \$200,000 loan, that amounts to \$500 to \$1,500, which can be paid up front or converted into a marginally higher interest rate.

But for borrowers with credit scores of 680 to 700, the charge is 1.5 percentage points, and for those between 660 and 680, the charge is 2.5 percentage points. On a \$200,000 loan, the extra 2.5 percentage point fee can add roughly half a percentage point to the interest rate.

Fannie and Freddie started aggressively increasing prices on loans to higher-risk borrowers in 2008, said Guy Cecala, the publisher of [Inside Mortgage Finance](#), an industry trade publication. In August 2008, for instance, borrowers with credit scores of 680 to 700 incurred a charge of one percentage point of the loan amount, when making a down payment of 20 to 25 percent.

Brad German, a spokesman for Freddie Mac, said this so-called risk-based pricing approach was necessary to protect the agency and the investors buying the mortgage securities against losses from foreclosures.

Mortgage brokers, meanwhile, complain that these pricing formulas place too much emphasis on credit scores, which, the brokers argue, don't accurately reflect a borrower's likelihood of defaulting on a mortgage.

Michele Raab-Francis, the chief executive of the Safe Harbor Capital Group in Bellport, N.Y., says credit scores of 680 are common among people who have taken on several credit cards with high spending limits — even if the borrowers carry low revolving balances. “If you have 20 percent for a down payment and 10 years of solid employment and savings and a 401(k) but a credit score of 680,” she said, “it's not right to penalize you based on that alone.”

Mr. Cecala of Inside Mortgage Finance said, “We're getting to the point where the mortgage market is really for people with the best credit, not the average person.”

Still, there may be hope for borrowers. Last year Fannie Mae and Freddie Mac considerably slowed the pace at which they imposed more penalties on those with lower credit scores. Mr. Cecala noted, too, that in the final quarter of 2009, the average credit score for a Fannie or Freddie loan was 758, down from roughly 761 in the third quarter.

“It seems to suggest the pendulum swung too far, and there are some adjustments being made,” Mr. Cecala said. “They're also addressing the fact that they won't have a business if they leave the standards where they were.”