



Navigating today's underwriting guidelines

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WITHIN THE INDUSTRY, THE CURRENT PARAMETERS ON

underwriting standards have become a topic of divisive debate. On one side, many originators and secondary marketing officers believe standards have contracted to a point that they are beginning to suffocate the market. On the other side, some believe that current underwriting standards are not creating any great damage; instead, they are offering something of a life preserver to an industry that is still treading water.

View 1: Current underwriting standards are suffocating the market.

As mentioned, many originators feel that underwriting guidelines have been reconfigured with too much fear of the potential risk. This group believes that tightening underwriting standards will not prove to be beneficial for the industry and, by extension, the recession-afflicted economy. They assert that attempting to correct the market by placing greater pressures and controls on underwriters can have a negative effect on the recovery effort.

"Mortgage underwriting guidelines have indeed tightened," says Dick Wertzberger, senior vice president of mortgage banking at Landmark National Bank. "I am always amused at the word guidelines. By definition, guidelines are to direct the underwriter and all those involved in the origination process on how to process and underwrite a home loan. Given today's climate, we might as well call them underwriting commandments!"

View 2: Current underwriting standards are not creating any damage.

There are also those across the industry who are not complaining about underwriting standards. From their perspective, underwriting standards aren't much different than they were a few years ago. They believe that the present economy is having a negative impact on mortgage volume, but adopting irresponsible underwriting practices to bolster volume is not an acceptable response.

Some of these lenders have typically required 20 percent down, even during the housing market heyday. They look at FICO, but are not FICO-driven—and each loan is reviewed case by case. As a result, this group believes that the present state of underwriting will help stabilize a still shaky market.

Finding common ground

If there is common ground in the debate, it comes in the agreement that today's underwriting standards represent the residue left behind when the housing bubble was unceremoniously deflated. Both sides agree that singling out underwriters as the villains behind that crisis is unfair. Underwriting may have been a symptom of the problems, but it was not the cause.

Instead, the culprit could be the easy monetary policy of the last 50 years, along with the inability of the authorities to control the flow of credit.

"The fatal mistakes in the bubble and burst were the low down payment and exotic adjustable-rate mortgage products, including Alt-A mortgages, and not subprime, per se," says Dr. Anthony Sanders, professor of finance at George Mason University in Fairfax, Va. "The other fatal mistake was the overreliance on credit scores as a substitute for thorough underwriting."

Indeed, we are seeing a shift toward higher FICO scores, an indication that lenders are tightening their underwriting standards. In 2009, more than half of one-to-four family loans were made to borrowers with scores above 720. Less than 20 percent were to borrowers with FICOs of 679 or lower.

The other reality facing those who originate and sell is that investors are quick on the recourse trigger button, forcing the underwriter to treat guidelines as fact. It's no longer enough to know the agency guidelines; you must be familiar with the overlays that private mortgage insurance companies and investors have added as well. Appraisals trump credit every time.

We will not return to the period from 2000 to 2007, when everyone received a home loan, but we are likely to see credit requirements and credit scores loosen up again. For now, the emphasis is on home lending versus homeownership. Today's underwriting will ensure that only the best-qualified borrowers receive mortgages that they will ultimately repay without incident. And when we come out of this, we will be a better industry for it. □

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