ECONOMY

Fed Survey: Mortgage Standards Ease for First Time Since Housing Bust

'Broad-Based Pickup' Seen in Demand for Business Loans

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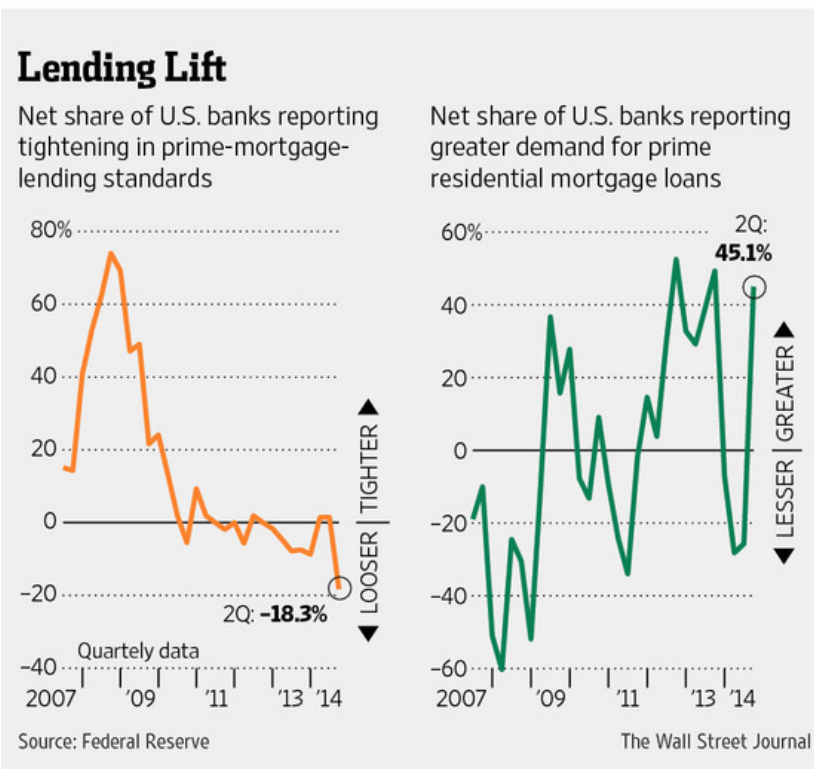
Nearly one in four U.S. banks said they had eased mortgage-lending standards for borrowers with strong credit during the second quarter, the largest such movement by lenders since the housing bust hit nearly eight years ago.

As well, the Federal Reserve's quarterly survey of banks' senior loan officers showed that nearly half of large banks and foreign institutions believed lending standards for riskier syndicated loans to companies with noninvestment-grade, or junk, credit ratings were easier than the post-2005 norm.



The survey, conducted in early July, follows recent warnings from the Office of the Comptroller of the Currency over eroding underwriting standards in the market for high-yielding loans issued to below-investment-grade firms.

Banks said they had eased standards on commercial and industrial loans primarily because of more aggressive competition from other lenders amid growing competition between banks in a slow-growth, low-interest-rate environment, though some also said an improving economic outlook had contributed somewhat.

The survey showed that lenders continued to ease standards on loans to businesses "amid a broad-based pickup in loan demand." It also showed that more banks signaled easier standards for commercial real-estate loans than had been the norm since 2005.

Though bank lending to businesses has accelerated throughout the five-year recovery, banks have until now remained more cautious about lending to households. Lending standards for mortgages are easing amid sustained increases in U.S. home prices and a plunge in refinancing activity over the past year.

Demand for prime mortgages rebounded to its highest level in a year, according to the Fed survey, offering a hopeful sign for housing markets that have stumbled during the first half of the year.

Despite an uptick in the number of banks that signaled easier standards on mortgage lending to prime borrowers, most banks said standards remain tighter than normal. There are few signs that standards are easing for borrowers without good credit.

Top policy makers have repeatedly raised concerns over the past year that tight credit standards could hamper the housing recovery. While standards should have ratcheted up after the housing bubble, "it is now become the case that any borrower without a pretty pristine credit rating finds it awfully hard to get a mortgage," said Fed Chairwoman Janet Yellen at a congressional hearing last month.

Home sales have disappointed economists during the first half of the year amid weaker demand, lower inventories and higher prices. Mortgage rates jumped by a full percentage point last year, to around 4.7% in July 2013 from 3.6% in May 2013 for the 30-year, fixed-rate mortgage, according to the Mortgage Bankers Association. But rates have declined modestly since then and have bounced in a narrow range over the first half of this year. They averaged 4.3% in late July.

Many mortgage lenders have said standards remain far more stringent than they would at this point in a normal recovery for a few reasons. Among those reasons: increased costs associated with handling defaulted mortgages; new regulations that have taken effect this year; and continued uncertainty over so-called mortgage put-backs in which loan investors and insurers are forcing banks to take back loans that have underwriting defects.

The survey offered one sign that lending standards could be slow to thaw even if mortgage rates head higher and lenders search for more business. New rules took effect in January that allow for tougher penalties if lenders fail to verify a borrower's ability to repay a mortgage. Around one-third of lenders polled in the survey said those rules had led to a lower approval rate for prime borrowers. The balance said they hadn't any noticeable effect on approvals.

Most loans that are eligible for purchase by federally backed entities are currently exempt from the ability-to-repay provisions. Nearly half of respondents said the provisions had curbed loan approvals on so-called jumbo mortgages that are too large for government backing and therefore aren't exempt from the provisions.

Some economists say an equally large headwind facing the housing market is consumers that are too weak. Too many can't borrow because they have high levels of debt, damaged credit from the recession or insufficient incomes to become home buyers. Looser credit standards can only do so much to easily address those challenges.