How Dodd-Frank changed housing, for good and bad

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The effect of loose lending during the last housing boom was abundantly clear: Nearly 8 million U.S. homes fell into foreclosure. The response was a slew of new lending rules under the Dodd-Frank financial reform law, and the result was a credit lockdown that continues today, nearly five years after the legislation was enacted.

"For lenders this is all about paperwork, verification and doing a lot of the grunt work that was ignored or passed over before the crisis," said Jaret Seiberg, a managing director at financing firm Guggenheim Securities.

The rules fill thousands of pages and have cost lenders millions of dollars in labor and software to revamp their systems in compliance, but at face value, they're pretty simple. Highly risky loan products, like negative amortization mortgages, are now banned. Borrowers must document their employment and debt levels. Lenders must disclose all the costs involved in each loan, and, perhaps most important, lenders must verify a borrower's ability to repay the mortgage.

That last one may sound ridiculous, but it was the fundamental reason for the financial crisis in housing. Borrowers were given loans they could never repay.

"If you're a high-quality credit consumer, Dodd-Frank just made it a much bigger pain in the butt to get a loan. You've got to fill out more paperwork, you've got to dig up more tax returns," said Seiberg. "You've got to find information related to retirement accounts, stuff that was never asked for before. But if you're on the low end of the spectrum, it has made it tougher to get that mortgage."

So tough that the average FICO credit score on loans made today are the highest in history. Tight credit, though, is blamed for a still-falling homeownership rate, now at the lowest in a quarter century.

"The biggest misconception is that you need a big down payment to buy a house. It's just not correct. What has changed is not the down payment, it is the credit and the ability to repay rule. Beyond that it's the documentation piece," said Craig

Strent, CEO of Maryland-based Apex Home Loans. "It's not hard to qualify, it's hard to get through the process because of the massive amounts of additional documentation that is now required."

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Borrowers, however, still complain that it is not just the process, but the level of creditworthiness that is keeping them out of the homebuying market; even the Federal Reserve chair, readying to raise interest rates, says credit is too tight.

"Demand for housing is still being restrained by limited availability of mortgage loans to many potential homebuyers," said the central bank's chair, Janet Yellen, in testimony to the Senate Banking Committee on Wednesday.

Tight credit is also blamed for a shift in the lending landscape. Large bank lenders are moving out, and independent, nonbank lenders are moving in. Nonbanks now make up 43 percent of mortgage lending today, up from just 10 percent in 2009, according to *Inside Mortgage Finance*, an industry publication.

"Banks consolidated massively. The big four are so well-diversified that revenue stream from mortgages is not part of their headline strategy," said Anthony Hsieh, chairman and CEO of California-based loanDepot, a nonbank lender that has grown dramatically in just the past year.

Private sector investors have not returned to the mortgage market. Loans backed by government entities Fannie Mae, Freddie Mac and the FHA make up more than 90

percent of all new loans today, a historically high share. During the housing boom they were barely one-third of the market.

"I think Dodd-Frank, not only does it add complexity, but it adds a lot of confusion," said Hsieh.

It also adds significant costs in time and labor. Lenders like Apex Home Loans have had to hire dozens of additional staff just to comply with new rules.

"There are so many ways to make a mistake, and the banks learned from a financial crisis that the regulators will keep coming after you, over and over and over again for these errors," said Seiberg.

The rules may also stifle innovation in mortgage lending.

"It has slowed down lenders from taking chances again. Ultimately that may be good, and maybe that's what the law was supposed to do, but it is slowing down lending and certainly is making the housing recovery a little bit more difficult because lenders are not jumping in with new products," said Hsieh.

It now takes far longer for lenders to process the most basic loans. The average large bank underwriter could process about 165 loans per month in 2005 but can only do about 33 today, according to a study by the Mortgage Bankers Association.

"It's always about making certain that we double-check and once we do that we triple-check and then making absolutely certain that all the i's are dotted and the t's are crossed because if you don't and you make a mistake as a lender, you're not going to be around for long," said Hsieh.

The home loans being made today are arguably the most pristine in history. New default rates are at record lows. All that, however, comes at a cost to lenders, borrowers and the overall health of the housing market itself.