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Real Estate Outlook Gloomier As Lenders Further Tighten Lending

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Residential and commercial real estate markets are bedeviled by recurring woes despite rather reasonable expectations for the markets to restore to relative normalcy by now. In fact, the predominant practice of borrowing ONLY to a very elite and selected group of borrowers has inhibited even a semblance of real estate recovery. The outlook is grim and gloomy, as lenders continue to tighten already restrictive lending standards. Let us explore the rationale behind such declining and worsening real estate environment in more detail.

SOME BACKGROUND

In light of the financial crisis, lenders resorted to extreme measures to stanch real estate bleeding. Such measures included requiring borrowers to:

- Put Down Larger Down Payments.
- Possess Much Higher Credit Scores. And,
- Possess and Display Much More Detailed and Expansive Financial Documents of Their Assets and Income

1. INCREASING FORECLOSURES HITTING THE REAL ESTATE MARKET HARDER THAN EVER

Usually, after a period of financial doldrums, businesses seek to turn the page and become profitable by securing new businesses. Nonetheless, for real estate market, this trend is not necessarily the case as one crisis follows another one. In fact, the glut of foreclosures hitting the real estate market has exacerbated the already shaky real estate market and made lenders more reluctant and fearful of borrowing.

2. INCREASING RESTRICTIONS IMPOSED BY LENDERS

This is ironic that Fannie Mae and Freddie Mac as the government bulwark against private industry's strangulation of real estate market has become the impetus for further regulation and strangulation of such industry. In fact, Fannie Mae and Freddie Mac as quasi governmental entities (i.e. both private and public) weathered intensified pressure from Congress to ensure federal dollars are not spent on projects or drives similar to what led to the sub-prime mortgage crisis as a frightening prelude to a full-blown financial crisis.

MUCH HIGHER STANDARDS REQUIRED

Fannie Mae and Freddi Mac can now require banks to buy back loans they issued if Fannie and Freddi can prove the loan did not meet underwriting guidelines. This is an extremely exorbitant and somehow unacceptable proposition and specter for banks. With this in mind, banks have put into place the following rigid requirements, some even higher than what the Federal Housing Administration requires:

- **HIGHER CREDIT SCORES:** Despite Federal Housing Administration requirements to offer loans to people with around 580 credit score, banks do not lend to applicants with less than at least 640 credit score. This practice has made credit scores the salient barometer of financial health and prudence. In fact, average credit scores for Federal Housing Administration backed loans surpassed 700 in October 2010.
- **DETAILED REVIEW OF PAST TWO YEARS TAX RETURNS:** Although it is essential to ensure borrowers are capable of paying their mortgages by looking at their tax returns, zealously adhering to this practice might have some unintended consequences. For instance, most people take advantage of tax credits and deductions which reduce their taxable income. In addition, given the economic conditions, some borrowers have been unemployed during the financial crisis and are now employed with reasonably stable jobs. This latter concern also reduces the latter group's existing loan qualifications. Hence, since their tax returns reflect their unemployed status in the two past years, they are automatically deemed unqualified.

NOTE

This is extremely important to ensure borrowers are able to pay off their loans to proactively eschew the devastating problems which led to sub-prime crisis and other financial catastrophes. Nonetheless, extreme regulation and unnecessary diligence in unwarranted cases could further stagnate and even spur a double-dip real estate recession. In fact, it seems the pendulum has swung to the other direction rather imprudently and perilously.

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