Wall Street Journal

Rising Home Prices Push Borrowers Deeper Into Debt

Tight supply, higher mortgage rates make homeownership out of reach for many, pressuring lenders to ease credit standards

Real-estate agents worry that buyers' weariness from being priced out of the market could make this one of the weakest spring selling seasons in recent years. Photo: Steven Senne/Associated Press

By Laura Kusisto and Christina Rexrode
April 10, 2018 6:30 a.m. ET

More Americans are stretching to buy homes, the latest sign that rising prices are making homeownership more difficult for a broad swath of potential buyers.

Roughly one in five conventional mortgage loans made this winter went to borrowers spending more than 45% of their monthly incomes on their mortgage payment and other debts, the highest proportion since the housing crisis, according to new data from mortgage-data tracker CoreLogic Inc. That was almost triple the proportion of such loans made in 2016 and the first half of 2017, CoreLogic said.

Economists said rising debt levels are a symptom of a market in which home prices are rising sharply in relation to incomes, driven in part by a historic lack of supply that is forcing prices higher.

Real-estate agents worry that buyers' weariness from being priced out of the market could make this one of the weakest spring selling seasons in recent years.

Consumers are growing more optimistic about the economy and their personal financial prospects but less hopeful that now is the right time to buy a home, according to results of a survey released in late March by the National Association of Realtors.

At the same time, the average rate for a 30-year, fixed-rate mortgage has risen to 4.40% as of last week from 3.95% at the beginning of the year, according to Freddie Mac , FMCC 1.85% putting still more pressure on affordability.

These factors "are working against affordability and that's why you get the pressure to ease credit standards," said Doug Duncan, chief economist at Fannie Mae . FNMA +2.80% He said that pressure has to be balanced against the potential toll if underqualified buyers eventually default on their mortgages.

CoreLogic studied home-purchase loans that generally meet standards set by Fannie Mae and Freddie Mac, the federally sponsored providers of 30-year mortgage financing.

The amount of these loans packaged and sold by Fannie and Freddie increased 73% in the second half of 2017, compared with the first half of the year, according to Inside Mortgage Finance, an industry research group. Fannie accounted for the bulk of that growth. In that same period, overall new mortgages rose 15%.

Fannie Mae and Freddie Mac have been experimenting with how to make homeownership more affordable, including backing loans made by lenders who agree to help pay down a buyer's student debt or making it easier for self-employed borrowers to get mortgages. Several years ago, Fannie and Freddie started guaranteeing loans with down payments as low as 3%.

Sohani Rao, a software engineer in the San Francisco Bay Area, tried to buy a home for about a year but finally gave up a few months ago. Dozens of prospective buyers would show up for open houses, she said, even for homes in poor condition, resulting in bidding wars that put them out of her price range. Ms. Rao said loosening lending standards would only create more bidders.

"Thing are so bad right now," she said. "By doing this, they might have even made the problem worse."

Debt-to-income ratios measure the share of a household's pretax income that goes to paying a potential mortgage, plus credit card payments, student loans and other debt. Borrowers who find themselves saddled with too much debt might struggle to make their monthly mortgage payment or save for major repairs or other emergencies.

Todd Jones, president of BBMC Mortgage, said he is wary of making loans to borrowers whose debt-to-income levels would rise above 45% as a result, because they could find themselves stretched. "Every month is going to be tight," he said.

Last summer, Fannie Mae moved to back more loans made to borrowers with debt-to-income ratios of up to 50%, up from a typical limit of 45%. Freddie Mac also started backing more of those loans, according to industry researchers.

Fannie's new policy has resulted in 100,000 new mortgages that otherwise wouldn't have been made last year and early this year, according to the Urban Institute, a nonpartisan research organization.

Caliber Home Loans, a Texas-based lender, said 25% of its funded loans have debt-to-income ratios of greater than 45%, up from 10% about a year ago.

Economists warn that lenders must tread carefully in making credit more available, given the role easy mortgages played in creating the last housing bubble. The share of new buyers with debt-to-income levels in the 46% to 50% range remains well below the peak of just under 37% registered in 2007, but is nearing the levels of 2004-05, the years leading up to the bubble, CoreLogic data show.

So far lenders are making most of these loans to borrowers who have a history of good credit, though that could change. In the fourth quarter of last year, about 78% of the loans with debt-to-income ratios above 45% were made to borrowers with credit scores of 700 or more, according to Inside Mortgage Finance. Although standards vary by lender, usually any borrower below 650 is considered subprime.

"The problem," said Guy Cecala, chief executive of Inside Mortgage Finance, "is you're going to run out of [prime] borrowers."

The Urban Institute found that the share of borrowers with Fannie Mae-backed mortgages who had high debt-to-income ratios and had credit scores below 700 jumped to nearly 25% in the first two months of this year from 19% a year earlier.

"It's not a problem today, but it may be a problem tomorrow," said Stan Middleman, chief executive of Freedom Mortgage, a home lender.

Write to Laura Kusisto at laura.kusisto@wsj.com and Christina Rexrode at christina.rexrode@wsj.com