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Lenders Step Up Financing to Subprime Borrowers

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Loans to consumers with low credit scores have reached the highest level since the start of the financial crisis, driven by a boom in car lending and a new crop of companies extending credit.

Almost four of every 10 loans for autos, credit cards and personal borrowing in the U.S. went to subprime customers during the first 11 months of 2014, according to data compiled for The Wall Street Journal by credit-reporting firm Equifax.

That amounted to more than 50 million consumer loans and cards totaling more than $189 billion, the highest levels since 2007, when subprime loans represented 41% of consumer lending outside of home mortgages. Equifax defines subprime borrowers as those with a credit score below 640 on a scale that tops out at 850.

Lenders' interest in customers who were the hardest hit by the financial crisis reflects both the relative health of the U.S. economy and firms' desires to take more risks at a time when ultralow interest rates are depressing profits.

It also shows Americans are willing to take on more debt, which was reinforced by a Federal Reserve Bank of New York report released Tuesday that showed total household debt increased $306 billion, or 2.7%, in the fourth quarter of 2014 from the year-ago period, to the highest level since the third quarter of 2010.

Meanwhile, a number of new nonbank lenders are rolling out personal loans and other types of financing geared toward subprime borrowers. Such lenders face far less regulatory scrutiny than do big banks. Many of these firms are backed by Silicon Valley venture capitalists or funded by private investors or hedge funds seeking higher returns in the low-rate environment.

LendingTree Inc., an online-loan marketplace, said it helped arrange nearly 6,700 personal loans to subprime borrowers with FICO credit scores between 500 and 619 last year, up 761% from 2013, a surge the company attributes to growth in nonbank lenders entering the subprime market. "We're going from an era where for many years credit was extremely tight to an era where credit is now looser," said Gabriel Dalporto, LendingTree's chief marketing officer.

Borrowers with a FICO credit score of less than 650 owed roughly $48,000 on average across all debt obligations, including mortgages, as of October 2014, according to San Jose, Calif.-based Fair Isaac Corp., whose FICO credit scores, which range from 300 to 850, are used in most consumer-lending decisions. That figure was roughly $55,000 in October 2012 and about $61,000 in October 2008.

One exception to the rise in new subprime loans has been mortgages, which were the epicenter of the financial crisis of 2008. Mortgage lenders remain focused on borrowers with solid credit, according to industry data. Some $4 billion of subprime mortgages have been given out annually since 2009, down from a peak of $625 billion in 2005, according to trade publication Inside Mortgage Finance.

The push into subprime loans could have broad implications for the U.S. economy. Easy financing has already helped fuel U.S. auto sales, which totaled 16.5 million cars and trucks last year, an increase of 5.9% from 2013 and up 59% from 2009, according to automotive website Edmunds.com.

Some observers said the availability of subprime credit is a positive for borrowers and the economy. “This is helping people on a real level, helping them move forward,” said Dennis Carlson, deputy chief economist at Equifax.

Others are more concerned. “It’s good while the party lasts, but it’s exposing exactly the kinds of people to a negative economic shock that you don’t want to expose,” said Amir Sufi, a University of Chicago finance professor. Subprime borrowers, who pay much higher interest rates on loans than customers with good credit scores, are more prone to missing payments in periods of economic distress, said Mr. Sufi.

One potential check on the growth of subprime lending could come from the U.S. government. The Consumer Financial Protection Bureau is working on a requirement for some short-term lenders to consider borrowers’ ability to repay loans, out of concern that some are being saddled with loans they can’t afford. Such requirements already exist for credit cards and home loans.

Nonbank lenders catering to subprime borrowers said they are seeking to fill a void left by large banks, which have pulled back from riskier lending due partly to greater regulatory scrutiny.

Online lender Elevate Credit Inc., which started business last May, has since made $307.4 million in unsecured personal loans in the U.S. to borrowers with average credit scores between 580 and 625. The firm, based in Fort Worth, Texas, offers this type of loan in 15 states and charges fixed interest rates of 36% to 365%. However, interest-rate caps imposed by states such as New York and Maryland prevent it from making high-rate loans in some parts of the country.

“We believe there’s a big opportunity for not just us but a whole suite of new products to enter this space,” said Ken Rees, chief executive officer of Elevate. He was previously the CEO of Think Finance Inc., a former payday lender that is now a technology provider to the onlineloan industry. Elevate was spun off from Think Finance in 2014.

A competing online lender, San Francisco-based LendUp, has received more than $20 million in funding from venture-capital firms, including Google Ventures.

Many lenders said they are making loans only to borrowers at the top end of the subprime credit-score range, and they are reviewing additional borrower history such as bank-account transactions and income. This type of due diligence wasn’t as thorough with some lenders in the past.

After declining for the past three years, overall delinquency rates for car loans are rising, according to the New York Fed report. Some economists and consumer advocates are concerned that auto-lending practices are too risky and could result in more loan defaults.

While some large banks have regained an appetite for subprime car loans, most are resisting expanding into other types of subprime lending. Cars are relatively easy assets to repossess when a borrower stops paying the loan. By contrast, when borrowers default on unsecured personal loans and credit cards, it is difficult or impossible for a lender to recover its losses.

Another startup lender catering to subprime borrowers was founded by Raj Date, the former No. 2 official at the Consumer Financial Protection Bureau. Mr. Date's firm, Washington-based Fenway Summer LLC, in January reached a deal with Louisville, Ky.-based Republic Bancorp Inc. to offer a credit card that is being pitched as a more affordable alternative to payday loans, which are short-term loans that often charge triple-digit interest rates.

The Build Card, which is being rolled out later this year, will charge an annualized interest rate of 25% to 30% and will cap borrowers' initial credit lines at $500, with the chance to increase as borrowers pay back their debts.

Glenn Hill, a 49-year-old dispatcher for an elevator company in the San Francisco Bay Area, said he signed up last month for a $7,500 four-year personal loan at a rate of 30% with Springleaf Holdings Inc. in Evansville, Ind., which lends to subprime borrowers.

Mr. Hill said he used the loan to pay off a higher interest-rate loan he had taken out from another lender a few years ago, as well as to pay for everyday bills. "It was either this or start defaulting on things," he said. "It was just take this loan and pray for the best."

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