

# Origination News

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## Some ARMs Find Advocates

NEW YORK—While products like payment-option adjustable-rate mortgages appear poised for another wave of upward payment shocks and have hurt the reputation of ARMs in general, a growing number of market participants are trying to counter with these developments by spreading the word that an ARM product doesn't have to be a bad thing for consumers.

While once-hot ARM product innovations that performed extraordinary badly during the recent boom, such as payment-option ARMs, are unlikely to return to the market any time soon, Shane Chalke, president of Tysons Corner, Va.-based Mortgage Harmony, told this publication that the banks and credit unions he works with have shown potential interest

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## Some Advocating ARMs

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in a new type of ARM in which payments can only be adjusted downward.

Mr. Chalke said these institutions may be offering modifiable loans that can be lowered annually to the level of an index that reflects the updated market value of their current rate at the borrower's request. This "mimics a competitive refinance," he said. Financial institutions appear to have some interest in doing this in order to hang on to customers and manage their prepayment risk.

This new breed of ARM not only negates the payment shock concern products like pay-option and interest-only ARMs



Shane Chalke

created for consumers, it also has a patented compensation component that aligns originators' interest with the lender's, Mr. Chalke said.

Meanwhile, although ARMs are still relatively scarce in the conforming market that has dominated the business, they are being used in the liquidity-strapped but improving jumbo/superjumbo market, according to David Adamo, CEO of Luxury Mortgage, Stamford, Conn. And now that restrictions on private equity players in the market have been loosened as he had hoped, he believes this could in upcoming quarters lead to increased originations of this type.

But specialty ARM products like pay-option and interest-only ARMs will probably remain absent from originators' product menus for the foreseeable future. The problem when it comes to these loans is not their adjustable-rate nature, but rather a combination of payment shock and lack of equity, notes Sylvia Alayon, vice president of operations for the Consumer Mortgage Audit Center, Fort Lauderdale, Fla. Analysts agree the

main reason POAs are a problem is they allow negative amortization. This feature allows for the loan balance to grow over time to upwards of 125% of the original mortgage amount.

In an event known as "recast," once the loan hits the balance cap or reaches 60 months in age, the borrower's monthly payment obligation increases

from a minimum monthly payment to a fully amortizing principal and interest payment.

Borrowers don't have to make the minimum payments on POAs that magnify their payment shock but recent history shows a fair amount of them have, said Huxley Somerville, group managing director and head of the residential mortgage-backed securities group at Fitch Ratings, New York. He said about \$134 billion of these loans are set to

recast over the next two years in the securitized market alone and they are not expected to perform well when they do.

### Mimicking refinancing.

So the market is unlikely to forget this product's potential downside any time soon.

Few if any are originating pay-option ARMs today. Ellen Bitton, chief executive officer of Park Ave. Mortgage, New York, told this publication they are now considered verboten and she has not seen them used in a long time. ■