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Banking & Finance

Regulators shaken by cocktail of residential loans on offer

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With the real estate boom that hit the country came a new trend in mortgages: The Adjustable Rate Mortgage (ARM).

ARMs give borrowers the choice of different monthly payment plans. Borrowers have the options of making minimum monthly payments, interest only payments, full principal and interest amortized over 30 years, or full principal and interest amortized over 15 years.

Interest only loans allow borrowers to pay the interest only for a few years, thereby keeping the payments low, and only later paying off the principal.

The greatest benefit of these loans is that the interest stays at the same rate so borrowers can predict exactly how much they will be spending each month for the next 30 years. Problems arise, however, once the interest is paid off and the payments become higher.

ARMs, though, can be even more problematic. This is especially so where borrowers choose the option of paying the minimum monthly payments because their payments could be less than the interest. Therefore, the higher, present-day interest gets added to the principal and continues to grow as time goes on.

Consequently, borrowers who maintain low payments for a few years start to feel the burn of the higher payments later when they have to pay off principal and interest at the same time.

With the drastic increase of the federal interest rate that our country is seeing, people are really feeling the burn.

The problem is so large, in fact, that finance regulators, including the Federal Reserve Board, the Federal Deposit Insurance Corp., and the Office of the Comptroller of the Currency, issued guidelines to lenders in late September.

The regulators, skeptical of the cocktail of loans available to borrowers, feel that lending standards need to be tightened. They have instituted certain procedures that lenders need to follow in determining who qualifies for a loan.

Fearful of the effect a large number of defaults could have on the overall economy, these procedures force lenders to consider whether borrowers will be able to make the future, higher, payments, and not just the present payments. The guidelines also require that lenders explain the risks better to borrowers both in advertisements, and during the application process.

The guidelines, however, do not apply to state lenders whose operations are not covered by federal law.

People have also been taking their finance problems into their own hands. Many have been refinancing their ARMs either into Fixed Rate Mortgages, in which the rate never increases beyond a certain amount, or into more stable ARMs, such as the interest only.

There are also ARMs that will maintain the same interest rate for 7 or 10 years, thereby forcing borrowers to pay a higher monthly amount but allowing them to maintain their interest rate for some time.

Almost 44 % of all loans these days are being refinanced, but people are starting to shy away from ARMs altogether and opt for Fixed Rate Mortgages.

Most people are just tired of being at the mercy of the market in light of the interest rate increases. This is even true of New York, where ARMs were very popular.

It is predicted that the ARM and interest only trend will end now that people have really felt the rise of interest rates and the federal guidelines are in place. ■

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