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1688 new records were added to our database at 2:00 PM, on August 29. The system now contains 1989751 records.

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PUBLIC NOTICE
2008-8-29 11:18 AM

Mortgage industry more cautious, but not totally backing away from ARMs

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Daily Reporter Staff Writer
08/29/2008

To some, the term Adjustable Rate Mortgage falls under the same umbrella as mortgage crisis and foreclosure. However, industry experts contend that ARMs didn't always have such a negative connotation and that the stigma attached to them right now isn't likely to stick.

Both Marianne Collins, senior vice president of mortgage lending at Columbus-based Insight Bank and a member of the Mortgage Bankers Association's board of directors, and Itzhak Ben-David, assistant professor of finance in the Fisher College of Business at The Ohio State University, say the rise of the ARM dates back to the early 1980s, when interest rates were in the high teens.

Fixed-rate loans were unaffordable for many consumers and adjustable rate loans gave them a lower rate option, Collins said.

In the past, the rate was always lower on ARMs, compared to fixed-rate products, because the consumer was trading the security of a fixed rate for a lower rate in the beginning years of the loan, she continued, adding that for the borrowers who didn't plan to stay in their homes for a long time, ARMs were often better options.

In the early 2000s, mortgage markets opened in the sense that many new investors were looking to buy mortgages, even those that belonged to high-risk borrowers, Ben-David said.

These borrowers did not qualify before for traditional mortgages because of their low credit scores or because they did not have sufficient funds for downpayment, he said, adding that ARMs were ideal mortgages for such borrowers because they could afford their monthly payments - at least in the short term. Wall Street saw an opportunity to guarantee high yields to their investors and created ARM products that would accomplish that goal, Collins said. In order to guarantee those yields, pre-payment penalties were added so investors could realize that income for a guaranteed period of time.

Meanwhile, borrowers were offered lower start rates if they took pre-payment penalties instead of ARMs without them, or fixed-rate products, she said. The underwriting guidelines were very relaxed, allowing for little or nothing down and, in many cases, no income verification, she continued. Combined with very high margins, over and above the index, these loans were doomed to fail at rate adjustment.

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| | + | = | |
| Annexation | 0 | 1021 | |
| Bid Notice | 2 | 1062 | |
| Divorce | 0 | 1629 | |
| Foreclosure | 0 | 6449 | |
| Juvenile | 0 | 27998 | |
| Misc. | | | |
| Notice | 1 | 5421 | |
| Probate | 0 | 5718 | |
| Total | | 49298 | |

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That's not to say all ARMs are bad, Collins said. In fact, depository institutions still make traditional ARM loans when issuing loans that will stay in their portfolios.

Those loans have performed very well because those loans are adjusting at rates lower than current fixed rates, based on traditional margins and indexes, she said. The problem lies in the non-traditional ARMs and subprime ARMS, which most depository institutions have shied away from.

With one popular subprime ARM - a 2/28 ARM - borrowers paid short-term low interest rates in the first two years and then fixed their interest rates on medium- or long-term interest rates, Ben-David said.

If the loan reset in 2005 or 2006, they faced higher interest rates, which potentially contributed to the loan becoming delinquent, he added. Subprime ARMS were designed for borrowers whose credit did not qualify for prime ARM products, Collins said. They, like other subprime products, were at much higher interest rates because of the risk involved in making them.

For several banks, the risks associated with making non-traditional and subprime ARMs didn't pay off, though.

For instance, IndyMac was huge into originating the Option ARM product in both the retail and wholesale arenas, Collins said, adding that the bank was taken over by the Federal Deposit Insurance Corp. in July as a result of its loan losses.

Total assets of problem institutions recently increased from \$26 billion to \$78 billion, with \$32 billion coming from IndyMac Bank alone, according to the FDIC.

Additionally, Goldman Sachs recently announced that Washington Mutual, another big originator of Option ARMs, will remain unprofitable through 2009 as a result of credit related charges, including foreclosure costs, Collins said. The bank announced a \$3 billion loss for Second Quarter 2008.

Plus, National City lost \$1.8 billion that same quarter due, partly, to loan losses, mostly subprime product, she said.

Nonetheless, Ben-David and Collins said, these situations do not spell death for the ARM.

In the short run, lenders and regulators will be cautious about ARMs and will require higher downpayments, Ben-David said.

However, in a few years, borrowers, lenders and regulators may be induced to relax lending requirements and allow ARMs again following a strong real estate market period, he added.

Many borrower's prefer ARMs and lending institutions that portfolio loans will always offer them, Collins said. It is the non-traditional products, both ARMs and fixed, that have disappeared from the market.

Collins said that in her 31-year career, she has seen many market fluctuations.

But this one has been different because those non-traditional products did not play into the downs in the markets of the past, she said. They are now gone. The housing crisis has taught the lending industry a big lesson. We are back to basics.

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