Alternative and Non-traditional Mortgage Products

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Topics Covered

- Definitions – including brief description of various mortgage products and their advantages and disadvantages
- Federal Guidance and Proposed Guidance for State Regulators

Some definitions required to understand various mortgage products

- Index
- Margin
- Caps – both interest rate and payment
- Convertibility
- Negative amortization

What Are Non-traditional Mortgages?

- To define non-traditional, start with the definition recognized by the average consumer for a traditional mortgage, generally a fixed rate for a fixed period of time, and everything else is non-traditional.

Types of Alternative or Non-traditional mortgages

- Fixed Rate Mortgage – term other than 30 years and/or payment other than monthly
- Adjustable Rate Mortgage (ARM)– basis of adjusting and/or convertibility
- Interest only and payment option ARM – so called “smart loans”
- Low/No Doc Mortgage
- Two step mortgage (Balloon)
- Reverse Mortgage

Fixed Rate Mortgage

- Can be up to 50 years
- Payment arrangements from biweekly to annually

- Advantages – payments remain the same, terms of mortgage are known.
- Disadvantages – generally the longer the loan the more interest paid.

Adjustable Rate Mortgage

- Interest rate, therefore payment, adjusts
- Adjustment based on an index and specific loan terms: adjustment period, index, margin and caps
- Advantages – generally lower initial payments
- Disadvantages – it adjusts

Interest Only Mortgage

- Pay only interest for a specified time, then pay principal and interest.
- Advantages - lower payments initially
- Disadvantage – payment and/or interest changes

Payment Option Adjustable Rate Mortgage

- Allows options for payment – so called “smart loan” – traditional payment of principal and interest, interest only or minimum
- Advantage – allows borrower flexibility
- Disadvantage – can result in negative amortization

Low/No Doc Mortgage

- Generally lender does not require proof of income and/or assets
- Advantage – for individuals that have seasonal/infrequent income or self employed
- Disadvantage – generally more risk for lender therefore more expensive

Two Step Mortgage or Balloon Mortgage

- Fixed payments for a short period, then payment of remaining balance (balloon).
- Advantage – low payments for initial period
- Disadvantage – balloon comes due

Reverse Mortgage

- Allows those that own or have substantial equity in their home to be paid from the equity. Can be either lump sum or periodic payments.
- Advantage – can provide money to homeowners
- Disadvantage – lowers equity in home and must be repaid upon the occurrence of certain events

Federal Guidance on Non-traditional

- Applies to federally regulated entities
- *Loan Terms and Underwriting Standards*
- *Portfolio and Risk Management Practices*
- *Consumer Protection Issues*

CSBS/AARMR Joint Guidance

- Applies to State Regulated entities
- Similar in scope to Federal Guidance