

# ARMs Can Diversify Mortgage Options

*They Also Combat Downturns and Instill Greater Member Trust*

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Until the pandemic hit, adjustable rate mortgages (ARMs) had been working their way back into the mainstream despite the bad rap they earned during the housing crisis.

Ellie Mae reports show the number of mortgages with adjustable rates increased from 5.5% of all new originations in January 2018 to 8.6% in January 2019.

Leading up to the 2008 crisis, lenders originated an increasing number of ARMs with initial adjustments after just one year, or within the first couple of years. This quick adjustment frequency, combined with substantial rate increases at each adjustment, led to significantly higher and unsustainable mortgage payments in a short period of time.

As a result, many ARM borrowers defaulted.

One problem with ARMs originated before the housing bubble burst: the prepayment penalty, which discouraged borrowers from refinancing—if they even had enough equity to do so. (Many lenders approved ARMs for purchase transactions in those days with no down payment required.)

## **RULES HAVE LIMITED RISK**

Safeguards built into today's ARMs make them less risky. Lenders now

properly qualify borrowers based on how much future payments will be after the rate adjusts, instead of only the initial lower payment amount—a common practice before the subprime mortgage market collapsed.

Current ARMs also limit how much a mortgage can adjust, and include caps that prevent the interest rate and payments from rising too quickly.

With mortgage rates at historic lows, borrowers are more likely to choose

fixed-rate mortgages than ARMs. But when interest rates go up, ARMs will regain popularity as an attractive option to borrowers, especially members who do not expect to be in their homes for a decade or longer.

Credit unions that offer ARMs diversify their mortgage options and meet the needs of different kinds of borrowers. They also gain competitive advantages that allow them to better serve members and create another source of new loans.

By taking advantage of a lower initial rate, borrowers whose long-term intentions align with ARM features can save money and more quickly pay down their obligations, creating future wealth and bor-



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rowing potential.

In turn, credit unions benefit by producing a true widget in the world of loan originations: a risk-friendly asset that can be held in portfolio (if properly underwritten) and sold to turn capital as necessary.

### ANTICIPATING A DOWNTURN

As the economy normalizes, most credit unions, which are now experiencing a pandemic-induced mortgage and refi boom, expect volume decreases. ARMs can help combat such inevitable downturns in business.

They can also, however, present unique challenges for credit unions, whose core systems often cannot adequately originate or service the loans.

Key compliance challenges include:

- Unique early disclosures.
- Calculations in the origination process.
- Adjustment notices.
- Considerations in loan servicing.



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The impending discontinuation of LIBOR also has important implications for new originations and requires comprehensive risk assessments in the servicing of impacted legacy ARMs.

The advantages of properly offering ARMs, however, far outweigh the hurdles credit unions must clear to do so.

### SOLUTIONS FOR CREDIT UNIONS

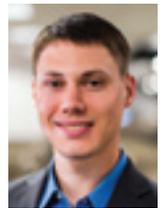
Solutions include a seamless, white-label partnership with the right credit union service organization (CUSO) that can manage the entire mortgage operation behind the scenes. Or, credit unions can take on the task themselves

by upgrading technology, searching for a secondary market outlet and training staff to ensure salability.

Whatever route they take, credit unions that expand their mortgage lending programs also ultimately build greater member trust and satisfaction. Offering a comprehensive selection of products helps to ensure they can match diverse borrowers with the mortgages that best suit their varied needs.



*Andrew Duncan is Vice President of compliance at TruHome Solutions, a CUSO-owned mortgage company offering a full range of private-label services to credit unions nationwide. In his role, Duncan helps solve compliance gaps and challenges, affording credit unions time and resources to do what matters: serve members.*



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