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OTS 99-17 - OTS Director Seidman Suggests New Track Record Adjusted Mortgage

Office of Thrift Supervision

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OTS Director Seidman Suggests New 'Track Record Adjusted Mortgage'

WASHINGTON, D.C., March, 23, 1999 - Director Ellen Seidman of the Office of Thrift Supervision (OTS) today proposed a new home mortgage product aimed at borrowers who have a less than A credit rating by stepping down the interest rate to A levels once they have demonstrated a new track record of creditworthiness. She labeled the product, Track Record Adjusted Mortgage (TRAM).

Ms. Seidman said the concept of the new product is prompted by "the concern...about borrowers opting for higher rate mortgages to get into a home now rather than working through available counseling programs to improve their credit so they can finance future home purchases at better rates." She unveiled the TRAM at a meeting of the Fannie Mae National Advisory Council.

While not claiming exclusive originality for the concept, she said the terms of the TRAM can capture the concept of rewarding those who establish a new creditworthiness in varying ways. For example, the step-down could be a pre-established amount contained in the original note and triggered when a certain condition is met - say 24 consecutive months of payment as agreed.

A more complex variation with less interest rate risk and credit risk would allow the step-down to be elective after a condition precedent - perhaps completion of a certified credit or housing counseling program and 12 consecutive months of on-time mortgage payments, but at a rate based on the borrower's credit score and "A" market rates at the time of election.

"The benefits to consumers - particularly low- and moderate-income borrowers with little equity or up-front cash for refinancing - is that they are not saddled with premium rates once their creditworthiness has improved," Ms. Seidman asserted.

"The benefits to lenders, especially those who retain servicing rights, is that prepayment risk can be reduced. In addition, there is a powerful incentive during the qualifying condition period not to default, and longer-term default risk is also likely to be reduced in view of the decrease in P&I (principal and interest) payments going forward," she added.

Ms. Seidman acknowledged that some may question the need for the TRAM in the face of refinancing trends that have decreasing break-even points. But low- and moderate-income borrowers, especially first-time home buyers with impaired credit, "continue as a group to lag behind the conventional market in taking advantage of refinancing opportunities." When they do, it is likely to be at the expense of a greater portion of their home equity than the rest of the market.

"Such undue erosion of equity at the lowest rungs of the home-ownership ladder is bad social policy when less onerous alternatives, like TRAM, can be made available," she declared.

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