CALIFORNIA ASSOCIATION OF REALTORS®

March 29, 2006

John C. Dugan
Comptroller of the Currency
250 E Street, SW
Washington, DC 20219

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RE: OCC Docket Number 05-21
Interagency Guidance on Nontraditional Mortgage Products

On behalf of the more than 195,000 members of the California Association of REALTORS® (C.A.R.), I am pleased to submit the following comments to the Office of the Comptroller of the Currency (OCC) in response to the proposed interagency guidelines on "Interagency Guidance on Nontraditional Mortgage Products." C.A.R. is the nation's largest state trade association and its membership includes real estate agents, mortgage brokers, appraisers, property managers and other real estate professionals. This experience has allowed C.A.R. and its members to observe the dramatic changes that have taken place in the home-buying process over the last five years; including the recent increase in the use of nontraditional mortgage products (interest only and payment option loans).

C.A.R. applauds the regulatory agencies for reviewing and addressing the issue of nontraditional mortgage products and protecting borrowers. However, C.A.R. is hesitant in supporting all the guidelines for fear that they are too restrictive and will hurt California's real estate market.

The regulatory agencies have requested comments on three aspects of the nontraditional mortgage market:

- Consumer protection issues,
- Loan terms and underwriting standards, and
- Portfolio and risk management practices.

Consumer Protection Issues

The evolution of the nontraditional mortgage market has led to an increase in the variations and complexity of these products. This evolution necessitates that lenders take the appropriate steps to educate potential borrowers on the

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benefits and risks of nontraditional mortgage products throughout the loan process.

Nontraditional mortgages have allowed lenders to offer original and unique home-buying tools that include variations in prepayment penalties, minimum payments, interest payments, interest rate adjustments, balloon payments, negative amortization, and other loan variables. The complexity of these loans requires that lenders do more to ensure that the homebuyer fully understands the terms of their loan.

C.A.R. supports the idea that lenders "should offer full and fair product descriptions when a consumer is shopping for a mortgage." This product description should include both the benefits and risks of the loan product. The consumer must understand that nontraditional mortgages may result in negative amortization and a potential decrease in equity. The consumer should be made aware of "payment shock" when an initial interest only (I.O.) payment or teaser introductory interest rate expires. The lender should go over potential payment increases using the actual dollar amounts of the requested loan. Because all loans have an interest rate cap, worst case scenarios are not difficult to calculate.

A popular tool used by lenders to sell nontraditional mortgages is the option of either refinancing the loan for another mortgage, or cashing out the appreciated equity. C.A.R. acknowledges that the above scenario is appropriate for a number of homebuyers; however, the reality is that this selling technique has been abused by a minority of lenders. A homebuyer's plan to refinance a nontraditional mortgage is dependent upon two primary factors: the uncontrollable state of the market at the time of refinancing, and the terms and conditions of the original mortgage. Borrowers must fully understand the original loan terms so they are not penalized for trying to refinance.

It is important that the lenders explain any prepayment penalty associated with the loan. This is especially true if the prepayment penalty expires after the interest only or teaser rate period expire. Borrowers are most likely to refinance their loans when mortgages become fully amortized and locked rates become adjustable. Therefore, uneducated borrowers who accept loan terms with prepayment penalties during this time may be seriously affected.

The education of the consumer should not stop at the application process, but must be continued throughout the life of the loan. C.A.R. supports the guideline that

lenders should provide monthly statements for nontraditional mortgages that includes "information about the consequences of selecting various payment options on the current principal balance. Institutions should present each payment option available, explain each option, and note the impact of each choice." This will allow consumers to continue to make well informed decisions that best benefit them throughout the life of the loan.

C.A.R. would also recommend that the regulatory agencies consider the practice of "steering" when finalizing the guidelines. Over the life of a loan, a nontraditional mortgage will cost the consumer more than a conventional loan. It is important that borrowers who could qualify for a conventional loan are informed of that. Lenders should be required to present all the loan options available to a qualified buyer, and allow them to make an educated decision on which loan is best for them.

Lastly, C.A.R. would like to remind the regulators that buying a home will be the largest purchase of many consumers' lives, and that the process is not only daunting to the most educated homebuyer, but can be overwhelming with the amount of paperwork involved. The need for the information that is provided to the borrower about a nontraditional mortgage to be clear and easily understandable to the layman can not be overstated. When borrowers agree to the terms of a loan, they must feel confident that they not only were given the best loan available to them, but that they completely understand it.

Loan Terms and Underwriting Standards

C.A.R. is concerned that the proposed guidelines for underwriting may prohibit potential homebuyers in many high-cost states, such as California, from affording the American dream of homeownership.

C.A.R. has supported and continues to support responsible lending, as well as laws and regulations that ensure the safety and soundness of a financial institution.

C.A.R. believes that nontraditional mortgage products are not merely a money management tool for wealthy consumers, but are also an opportunity to open the door to homeownership for millions of Americans who may otherwise be unable to realize the American dream. The recommended guideline that "the analysis of borrowers' repayment capacity should include an evaluation of their ability to repay the debt by final maturity at the fully indexed rate, assuming a fully amortizing repayment schedule," may curtail homeownership if applied incorrectly.

Lenders who specialize in nontraditional mortgage products understand that current income may not be the only factor to take into consideration, and have created reliable underwriting guidelines. The OCC and other regulatory bodies should grant these lenders the ability to use a **REASONABLE BASIS** to believe the borrower can repay the loan instead of the borrower having only the income capacity at the time of application.

C.A.R. would also like to comment on the regulators' concerns regarding "simultaneous second-lien loans." Homebuyers purchasing a home with less than twenty-percent down are not a new phenomenon. However, unlike in the past when a lender would require private mortgage insurance, homebuyers have come to realize the financial benefits of taking a second-lien to cover the traditional twenty-percent downpayment. The tax benefit of deducting the interest from a second-lien makes this a more attractive vehicle for homebuyers. A solution to this, and one that C.A.R. has advocated for and continues to advocate for, is allowing private mortgage insurance premiums to be tax deductible.

Portfolio and Risk Management

C.A.R. is concerned that requiring lenders to be overly conservative on the management of their portfolio and hold excessive capital in reserves will deter lenders from offering these loans.

The regulatory agencies have recommended that lenders:

- Maintain an allowance for loan and lease losses (ALLL) at a level appropriate for portfolio credit quality and conditions affecting collectibility; and
- Maintain capital levels that reflect nontraditional mortgage portfolio characteristics and the effect of stressed economic conditions on collectibility.

C.A.R. supports the continued vigilance of a lender's portfolio to ensure that depositors' assets are safe and sound. However, to the extent that the guidelines require lenders to set aside higher reserves and capital, C.A.R. feels this may needlessly curtail the nontraditional mortgage market.

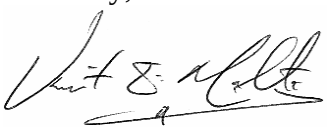
In 2005, estimates have placed the use of nontraditional mortgages anywhere from 30% to over 40% nationally. In California and other high-cost states the rates are even higher. The reality is that nontraditional mortgages have become an integral part of today's real estate market. As that market begins to level off and slow down, which we are currently experiencing, a sudden and dramatic reduction in capital and the removal and/or severe hindrance of a product utilized by so many of today's homebuyers will have an extremely negative impact.

Additionally, the proposed guidelines state that concentration limits should take into account geographic area as one of the factors to consider when setting limits on a portfolio. C.A.R. is concerned that California will be viewed unjustifiably as a geographic risk for nontraditional mortgages with its high rate of I.O. and negative amortization loans. The regulatory agencies must take into account that California has the lowest foreclosure rate in the country, and has historically been among the lowest for over twenty years.

There is no supporting evidence that as the real estate market progresses through its natural cycle that California will not continue to have a lower foreclosure rate than the rest of the country.

Thank you for your consideration of our views. If we may provide you with any additional information, please do not hesitate to contact Matt Roberts, Federal Governmental Affairs Manager, by phone at 213-739-8284 or fax 213-739-7255, or via email at matthewr@car.org.

Sincerely,



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