Remarks by
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Good morning. It's a pleasure to be here in Los Angeles and a privilege to participate in the Greenlining Institute's 13th annual Economic Summit. I want to commend you for all the work you've done since 1993 to bring more investment and better economic conditions to low-income and minority communities — hard work, diligent work, effective work that has given real meaning to the concept of "greenlining" communities that might once have suffered from discriminatory and destructive "red-lining."

Helping individuals and families to become new homeowners is, of course, one of the most important ways to strengthen and stabilize communities. It also happens to be very good for national banks, both directly in terms of business opportunities, and indirectly in terms of the economic growth that increased homeownership inevitably spawns. So this morning I want to focus on the ways that we at the OCC, by doing our job as the supervisor of national banks, are advancing the goal of broadly increasing access to homeownership.

We do it by supervising mortgage lending activities to make sure that banks prudently provide credit to their customers. We do it by encouraging effective partnerships between banks and non-profits to help prepare lower-income and other traditionally under-represented sectors of our society for homeownership – and to help keep them in their homes when they get into financial difficulties. We do it by providing

Community Reinvestment Act consideration for banks' initiatives in this area. And we do it by ensuring that all Americans have fair and equitable access to mortgages through our monitoring of industry practices and enforcement of the fair lending and consumer protection laws.

To put the current homeownership challenge in perspective, I'd like to take a brief look at the housing finance situation nationwide and here in California. Today, the national homeownership rate stands at an all-time high of 69 percent, with increases in mortgage lending spread across all income, racial, and ethnic groups. These gains reflect a variety of factors, including, among others, technological advances in mortgage lending, the growth in sub-prime lending, the increasing importance of government-backed lending, and the increased liquidity provided by the secondary mortgage market.

There has been an especially strong increase for minority borrowers. Indeed, the strong upward trend in lending to lower-income people and communities, and especially minorities, stands as one of the great housing accomplishments of the past decade. Between 1995 and 2005, the homeownership rate for minorities grew at more than double the pace for the general population and has risen from 43.5 percent to 51.2 percent. Having said this, there remains a 25-percentage point gap nationally in the homeownership rate between non-minorities and minorities and we need to do more to continue to close that gap.

More generally, in terms of affordability, it has been especially difficult to overcome obstacles to homeownership here in California. This state has the regrettable distinction of having nine of the ten least affordable metropolitan areas in the nation. The homeownership rate in California trails the national average by over nine percent, and the state ranks 49th in homeownership. Only New York ranks lower.

Moreover, according to the National Association of Realtors, only 17 percent of California households were able to afford the median-priced existing single family home, as compared to 50 percent of households nationwide. The median-priced existing single family home in California is more than double the national median, rising from $241,000 in 2000 to $524,000 in 2005. This dramatic increase — nearly 117 percent — far outpaced the roughly 10 percent increase in household income during the same period.

And that 117 percent increase is often exceeded in the real world. It's striking, for example, that in the largely Latino community of Lincoln Heights, just east of downtown Los Angeles, median residential resale prices have risen from $129,000 in 2000 to $395,000 in 2005. That's a 206 percent increase in just five years. According to a recent article in the Los Angeles Times, the lowest priced listing in this relatively affordable neighborhood — $375,000 — is for a two-bedroom, one-bath, 894-square-foot cottage built in 1908. That may well be a nice, modest home, but at that price it could also be beyond the reach of a modest-income worker relying on conventional lending.

And so we see — not surprisingly — increased reliance on nontraditional lending approaches to bring homeownership within the reach of more hard-working people whose increases in household incomes lag behind the increases in home prices. This includes dramatic increases in the mass marketing of nontraditional mortgages. Approximately 30 percent of all mortgages issued last year were interest-only mortgages and payment-option ARMs, according to Inside Mortgage Finance, which is really a striking statistic.

What's driving this new trend is the focal point for nearly all mortgage affordability issues: the size of the monthly payment. The traditional 30-year fixed rate mortgage requires a higher monthly payment than other types of mortgage products, because the lender, not the borrower, bears the risk of increased costs if interest rates increase over time. The certainty of fixed monthly payments is a valuable benefit to borrowers, but as house prices have increased dramatically over time, so have mortgages, and so has the typical monthly payment. This in turn has made it increasingly harder for borrowers of modest means to afford the monthly payment on a traditional fixed rate mortgage for even a very modest home – and in the world of mortgage underwriting, this has made it more difficult for such a borrower to "qualify" for such a mortgage.

This being America, markets have responded by devising new ways to reduce the monthly payment on a mortgage without reducing the size of the mortgage. One innovation of the 1980s, of course, was the adjustable rate mortgage or "ARM," which carries a lower monthly payment initially than a fixed rate mortgage because the borrower assumes the risk of increased costs if interest rates rise.

Of course, if interest rates *do* rise significantly, the borrower's monthly payment would exceed the amount required for a fixed rate mortgage of the same size. But that may not happen, and even if it does, it won't likely be for some time, and in the meantime, the borrower is able to qualify for the mortgage and buy the home. In periods of relatively stable interest rates, adjustable rate mortgages have saved borrowers a great deal of money and allowed them to purchase homes that they could not otherwise afford, though the risk of significantly higher payments in the future remains real.

In recent years, however, as house prices have increased dramatically, even the ARM has not been able to keep the critical monthly payment at the lower levels required for borrowers of modest means. Again, markets have responded, this time with nontraditional mortgages that can lower the required monthly payment still further as compared with traditional fixed rate mortgages or ARMs – but only for a limited period of time. During this initial period – typically five years but sometimes longer – an interest-only mortgage reduces the monthly payment by allowing the borrower to pay only the interest due on the loan each month, as opposed to also paying part of the principal, as would be required with a traditional mortgage. A payment-option mortgage goes one step further to reduce the monthly payment during the limited initial period: in addition to forgoing monthly principal payments, it allows the borrower to pay back only *part* of the interest that is due each month, with any unpaid interest being added to the underlying principal of the loan. In other words, the mortgage "negatively amortizes," so that with each monthly payment, the borrower's mortgage debt increases.

Of course, there is no free lunch.

After the limited initial period ends, the monthly payment for the holder of a nontraditional mortgage *must* increase – even if interest rates stay flat – and the size of that increase can be very substantial. At its core, the "bargain" in a nontraditional mortgage is that the borrower pays a lower monthly payment now in exchange for the near certainty of a higher monthly payment later.

So, with a typical 30-year interest-only mortgage, the borrower pays a lower monthly payment for the initial 5-year period when he or she is only required to pay interest. But after that period expires, the borrower has to start making principal payments as well. And because there are only 25 years left on the mortgage, not 30, the amount of principal to be paid each month is higher than it would be with a traditional 30-year mortgage. So the monthly payment increases in year 6 beyond the level that the borrower would have had to pay with a traditional mortgage.

Payment-option ARMs take this whole process one significant step further. During the initial period – again, let's say five years – the borrower has the option of forgoing both principal and some of the interest in making monthly payments, and the resulting negative amortization of course digs the borrower deeper into debt. When the period expires, the borrower's monthly payment increases not only because of the requirement to start paying principal over the shorter remaining loan period of 25 years, as is the case with an interest-only loan. In addition, because the size of the principal balance has increased through negative amortization, the amount of principal due each month is also increased.

In short, a payment option ARM allows the borrower to obtain a *much* lower monthly payment initially in exchange for a *much* higher monthly payment later. How big is that jump likely to be? Well, in one typical example that I have used involving a modest rise in interest rates of only two percent, the monthly payment can literally *double* overnight, at the end of the initial period.

Needless to say, that type of "payment shock" has gotten our attention. As a result, last December the bank regulatory agencies proposed guidelines to address the fundamental issues raised by nontraditional mortgages – specifically, that, over time, borrowers will experience substantial increases in required monthly payments that (1) they may not be able to afford, putting their homeownership at risk and exposing banks to substantial losses; and (2) they may not understand. Now that the comment period has ended and we are going through the process of reconciling our proposed guidance with the feedback received, I thought it might be helpful to discuss some of the concerns that have been raised.

Some have argued that, with house prices rising, nontraditional mortgages do not pose unreasonable risk because homeowners will experience equity increases and, if necessary, could refinance if they found themselves facing unaffordable payments. With respect to payment option mortgages, this argument assumes that housing prices will inevitably rise enough to cover any negative amortization that accrues. It also assumes the borrower's income and credit profile will permit him or her to refinance into a more affordable product, even where the principal balance has grown. But, in the real world, what goes up also can go down — just as average house prices actually did here in California for each of the years from 1991 to 1995. That type of price decline could leave a homeowner owing more on the home than it is worth, making it very difficult for the borrower to refinance — a situation that could threaten his or her ability to stay in the home.

So the first fundamental issue addressed in the proposed guidance is that, from an underwriting perspective, a borrower should be able to demonstrate a reasonable capability to make the required monthly payments under reasonably foreseeable circumstances. If monthly payments are likely to jump because of negative amortization and/or reduced amortization periods, then lenders *must* take these likely increases into account in demonstrating a borrower's capacity to meet the terms of the loan.

Many industry commenters objected to the specificity of the guidance in this area, arguing that regulators are prescribing too much detail on underwriting criteria — an area traditionally left to lenders. Concerns were also raised that the proposed underwriting procedures assume a worst-case scenario for all borrowers rather than making appropriate assumptions about the individual borrower's ability to manage the potential payment shock.

We acknowledge, of course, that many factors influence borrower performance, and that not all borrowers will make only minimum payments. Still, it is in neither the bank's nor the borrower's best interest to have a mortgage amount, or a payment structure, that a borrower is unlikely to be able to afford in the long run. The guidance proposes that underwriting standards should address this issue at inception — that is, by ensuring that qualification standards encompass any reasonably foreseeable payment requirements possible under the terms of the loan. In contrast, assuming only best-case performance unnecessarily increases risk to both parties.

The second fundamental issue addressed in the proposed guidance is this: do borrowers that buy these products really understand the very real possibility of dramatically increased payments in the future? To help answer this question, we looked at the actual marketing materials used by lenders to market payment-option mortgages. In many cases we found that such materials focused mainly on the initial low monthly payment and gave relatively little attention to the likelihood of much higher payments later. Going through this exercise led regulators to conclude, at least initially, that nontraditional mortgages are relatively complex and that borrowers unfamiliar with them

— which means most borrowers — would benefit greatly from improvements in both the content and timing of disclosures.

This is not to suggest — not by any means — that there should be some sort of wholesale clamp-down on the use of nontraditional products to extend homeownership opportunities to more people. Our proposed guidance makes clear that these products are perfectly appropriate if underwritten properly with meaningful disclosures – indeed, the essential purpose of the proposed guidance is to help lenders achieve this goal. Now that the public comment period has closed, we will be reviewing the comments carefully over the coming days to determine whether adjustments to the proposal are called for.

That leads me to the other homeownership topics I wanted to discuss today, briefly, beginning with the ongoing and increasingly urgent need for proactive counseling as a fully integrated component of homeownership financing. Fortunately, there are many housing counseling agencies across the country that have successfully partnered with banks to explain the homeownership process to consumers, help them prepare to become homeowners, and supplement a first mortgage lender's financing through down payment assistance and soft second mortgages. We know that homeownership counseling is important in decreasing delinquencies. The largest study of the effectiveness of such counseling showed that borrowers who completed counseling were 19 percent less likely to experience a 90-day delinquency than non-counseled borrowers.

Counseling agencies can be especially effective in reaching out to borrowers with blemished credit history who might otherwise end up with sub-prime loans. As lenders are learning, would-be borrowers who benefit from homeownership counseling —

including financial education and work to improve their credit profile — can often qualify for lower-rate conventional financing.

The OCC is proud to serve with HUD and the other financial regulators on the board of NeighborWorks® America, a national non-profit consisting of more than 240 resident-led, chartered groups in local communities. NeighborWorks® America has the nation's largest force of homeownership education counselors and has provided counseling to more than 570,000 individuals. Its local affiliates cultivate partnerships with governmental entities and the private sector to provide affordable loans to potential homebuyers, and its national foreclosure prevention center helps address issues arising from predatory lending practices as well as develop effective foreclosure prevention strategies.

Community-based development organizations across the country — including, for example, Neighborhood Housing Services here in Los Angeles — are also playing an important role in preserving homeownership by working with local lenders to minimize the number of delinquent mortgages that go to foreclosure. This is work that is every bit as important as helping people become homeowners in the first place. With their deep-rooted community connections, these organizations can serve as trusted intermediaries, working with borrowers who might not be as comfortable turning to a bank for help when they get into trouble. We're also seeing evidence that banks can achieve cost savings by partnering with non-profits in this way. I'd also like to note that the next issue of our *Community Developments* newsletter, which will be available online next week, will highlight a number of effective strategies for banks and non-profits to help homeowners *remain* homeowners. As I say, this is vital and commendable work.

I want to add a note about borrowers who are not able to qualify for a prime loan, either after they have been through counseling or because they choose to forgo this option. These consumers deserve some assurance that they will be treated fairly and will not be victimized by unfair or deceptive lending practices. The OCC has acted to guard against such potential abuses. While we have not seen evidence of predatory lending by national banks, we have taken preventive action to ensure that such lending does not occur. We are the only bank regulatory agency that has lending regulations specifically prohibiting unfair and deceptive practices in the mortgage lending process, and we have issued extensive mortgage lending guidelines to guard against predatory and abusive lending practices such as loan flipping and equity stripping. We carefully monitor national banks through comprehensive examinations, and we are prepared to take strong enforcement actions if we encounter evidence of predatory lending.

I want to close now by returning to a theme whose importance, in my view, can hardly be exaggerated. The only sure way to open the doors of homeownership to more people of modest means — and to more people who may have been marginalized because of their ethnic, racial, economic, or single parent status — is to work *together* to remove the barriers that stand in their way.

Within the OCC, our District Community Affairs Officers are working with national banks to help identify lending, investment, and service opportunities that can increase access to financial products and services for minorities. With me here this morning is Susan Howard, our Community Affairs Officer for California — and I am proud that Susan, like all of our community development professionals, strives to build the kinds of partnerships among banks and housing counseling agencies that can make homeownership more accessible, affordable, and sustainable for more people.

Why does a federal agency like the Office of the Comptroller of the Currency concern itself with homeownership? Because we know, as you do, that homeownership is synonymous with building healthier communities and stronger economies. Because we know, as you do, that increased homeownership means better school systems, reduced crime rates, and more civic-mindedness — and, of course, stronger and more stable banks. And because we know, as you do, that a core part of our mission is to promote fair access to financial services and to ensure that banks meet the credit needs of all the communities they serve.

Some day, perhaps, we won’t talk of a housing gap. You are engaged in the great work of moving that day closer, and it is a privilege to work with you toward that goal. Congratulations, and thank you very much.