The Primary Mortgage Market

Survey Findings Reveal Current ARM Design

Freddie Mac recently surveyed lenders on how they are currently structuring and pricing adjustable-rate mortgages (ARMs). The survey was conducted as part of Freddie Mac's weekly *Primary Mortgage Market Survey (PMMS)* for the week ending November 23. Findings show that most one-year ARMs are indexed to rates on Treasury securities and have annual and life-of-loan caps. Lenders frequently offer ARMs at initial period discounts to attract borrowers; qualification is based primarily on this initial rate. However, deep discounts are not prevalent. Only a few lenders had discounts greater than 2.5 percent.

The survey also found that lenders were charging an average initial rate on one-year ARMs of 11.28 percent, 214 basis points lower than the average fixed-rate mortgage (FRM) rate offered by the same lenders.

Characteristics of Current 1-Year ARMs

	Percent With Feature
Type of Index:	**100.0**
Treasury	89.4
Cost-of-Funds	8.5
Other	2.1
Periodic Rate Cap	**87.2**
1%	5.3
1.5%	8.5
2%	73.4
Life-of-Loan Rate Cap	**93.6**
5%	9.5
5%+	84.1
Both Periodic and Life Cap	**86.2**
Payment Cap	**12.8**
Both Payment and Life Cap	**7.9**
Initial Period Discount	**83.9**
Qualification Rate	**100.0**
Initial	69.8
Fully Indexed	22.9
Other	7.3

Source: Freddie Mac *Primary Mortgage Market Survey*, week ending November 23, 1984. Approximately 100 lenders participated.

1-Year ARM Pricing

	Mean	Minimum	Maximum
Initial Rate	11.28	9.75	13.50
Margin at First Adjustment	2.44	1.25	4.50
Fully Indexed Rate (Index-Plus-Margin)	12.48	11.50	14.35
Initial Points	2.78	1.00	5.50
Adjusted Margin*	2.76	1.62	5.00
Spread Off FRM (Initial Rate)	2.14	0.38	4.25
Initial Period Discount**	1.33	0.30	2.90
Ceiling Rate	16.30	14.75	19.00

*Adjusted margin is calculated by converting the ARM initial points to margin using a standard of 25 basis points per 1 initial point for those points over 1 (assumed to cover closing costs) and adding this amount to the margin at first adjustment.

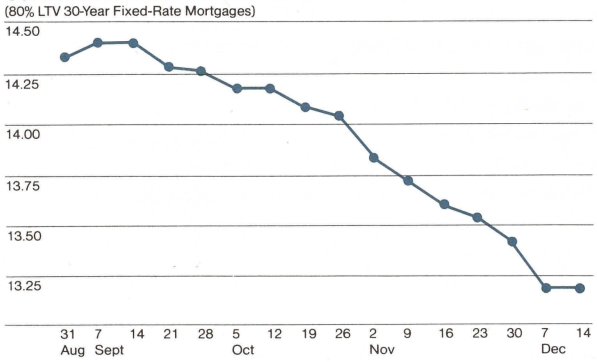
**Index-plus-margin minus initial rate for those loans with a discount.

The initial rate reflects the presence of discounts, which average 133 basis points for loans with this feature. Netting out the discounts, the average fully indexed rate on the ARMs is 12.48 percent, or 97 basis points below the FRM rate for the sample. Lenders currently charge slightly more points to originate ARMs than FRMs. The average number of points charged on a one-year ARM is 2.78, 20 basis points higher than the average number of points charged on FRMs. Finally, a majority of lenders set life-of-loan caps off the initial discounted rate. The average ceiling rate for the sample is 16.30 percent, which is almost exactly five percentage points higher than the average initial rate of 11.28 percent.

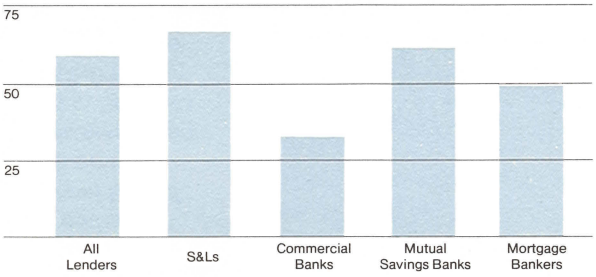
Surveys conducted by the U.S. League of Savings Institutions and the General Electric Mortgage Insurance Corporation indicate that short-term ARMs now dominate the marketplace. According to these sources, 80 percent of all ARMs have annual or more frequent rate adjustments.

Other findings of Freddie Mac's *PMMS* conducted throughout mid-November and early December reveal that primary mortgage rates continued to decline. The average rate charged on a conventional FRM in early December was 13.2 percent, the lowest rate since March. Yields on one-year Treasury securities, the benchmark for pricing most one-year ARMs, have fallen about 100 basis points in the past month.

Conventional Commitment Rate
(80% LTV 30-Year Fixed-Rate Mortgages)



Percentage of Loans Closed in November that are ARMs



Source: Federal Home Loan Bank Board. The series covers all purchase loans closed by survey participants during the first 5 full working days of a month. The data, particularly for individual institution types, may exhibit random fluctuation from month to month and should be checked against other sources when possible.