

ARMs Survey Reveals Continuing Trend Toward Standardization

The trend toward standardization among one-year adjustable-rate mortgages (ARMs) is continuing, according to the results of a recent Freddie Mac survey. In November 1984, Freddie Mac surveyed primary market lenders regarding the structure and pricing of their one-year ARMs. The findings revealed that these products had already become fairly standardized. A follow-up survey conducted last month indicates a continuation of that trend, particularly with regard to pricing.

Lenders have been able to successfully market ARMs—despite the fact that fixed-rate mortgage (FRM) rates are at six-year lows—because of the steep, upward sloping yield curve and lenders' use of initial-period discounts. Lenders are currently charging an average rate of 9.42 percent on their one-year ARMs, 244 basis points under their FRM rate. A year ago, the average initial ARM rate was 11.28 percent and 214 basis points below the FRM rate. In large measure, the current spread between the one-year ARM and the FRM simply reflects the spread between short- and long-term interest rates (the spread between one- and ten-year Treasury securities is currently about 200 basis points, compared with 170 basis points last year). In addition, lenders are making ARMs relatively more attractive by discounting the first-year rate an average of 133 basis points.

ARM margins have become much more standardized in the past year. Margins of 250 or 275 basis points were offered by 70 percent of the lenders surveyed.

The majority of one-year ARMs offered today have rate adjustments tied to Treasury securities. This year's survey indicates that 84 percent of one-year ARMs are indexed to Treasury securities, compared with 89.4 percent last year.

Characteristics of Current One-Year ARMS*	Percent with Feature
Type of Index	100
Treasury	84
Cost-of-Funds	10
Other	6
Periodic Rate Cap	100
1%	8
1.5%	4
2%	88
Life-Of-Loan Rate Cap	100
5%	60
5%+	40
Both Periodic and Life Cap	100
Initial Period Discount	92
Qualification Rate	98
Initial	82
Fully Indexed	10
Other	6

*Fifty lenders participated in the survey

One-Year ARM Pricing	Mean	Minimum	Maximum
Initial Rate	9.42	8.50	11.00
Margin at First Adjustment	2.55	1.85	3.00
Fully Indexed Rate (Index-Plus-Margin)	10.73	9.88	12.25
Initial Points	2.55	1.00	4.75
Adjusted Margin	2.94	2.25	3.625
Spread Off FRM (Initial Rate)	2.44	.75	3.50
Initial Period Discount	1.44	.23	2.75
Ceiling Rate	14.56	13.50	17.375

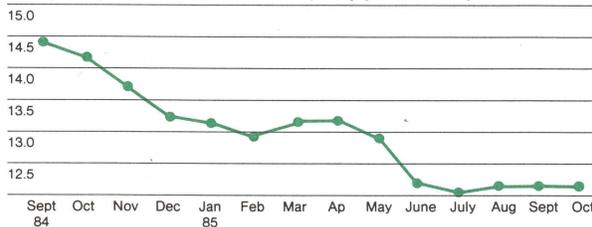
Periodic and life-of-loan rate caps have become standard features on one-year ARMs. All of the lenders surveyed this year offered ARMs with periodic and life-of-loan rate caps, while in 1984, 87.2 percent offered periodic caps and 93.6 percent offered life caps. The 2 percent cap is the predominant annual rate cap, accounting for 88 percent of the total. The 5 percent cap was the most frequently offered life-of-loan cap, accounting for 60 percent of the total.

by Dave Andrukonis

The Primary Mortgage Market

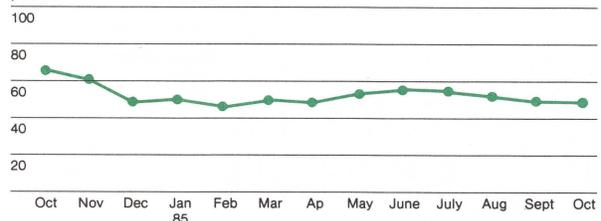
Conventional Commitment Rates

monthly averages based on Freddie Mac's Primary Mortgage Market Survey



ARMs' Share of Total Loans Closed

percent



Source: Federal Home Loan Bank Board