Housing and The Economy

ARMs in ARMageddon

Freddie Mac's sixth annual survey of Treasury-indexed ARM lending programs reveals some significant changes when compared with last year's survey.

First, lenders have divorced themselves from ARM teasers. While the average 1-year Treasury rate fell more than 1 percent over the past year, the average initial rate on a 1-year ARM was actually slightly higher in this year's survey than in the survey a year ago.

To the extent that borrowers have been opting for 1-year ARMs, there's been no change in their desire for those with a convertibility feature. Our survey revealed that half of the 1-year ARM applications were for convertible ARMs, the same percentage as in the previous survey.

Nearly 60 percent of the lenders surveyed offered 1-year jumbo ARMs (loans with balances exceeding the conforming loan limit). The average interest rate on jumbos was 30 basis points higher than on conforming 1-year ARMs. But there's not much difference between jumbo and conforming ARMs on points or margin.

Interestingly, this difference in the rate between conforming and jumbo ARM loans is much less than the respective difference on fixed-rate loans; the jumbo FRM rate is almost 60 basis points higher than on conforming FRMs. This may reflect the highly developed nature of the secondary mortgage market for fixed-rate product and the importance it places on that product being conforming.

ARM Characteristics Comparison: 1988 to 1989

Survey Week	12/9/88	12/1/89	12/9/88		12/1/89	
	1-Year ARM	1-Year ARM	3/3 ARM	3/1 ARM	3/3 ARM	3/1 ARM
Initial rate	8.35%	8.46%	9.81%	9.57%	9.46%	9.47%
Margin	2.75	2.77	2.76	2.72	2.75	2.73
Initial rate discount[a]	3.27	2.06	1.95	2.13	1.07	1.04
FRM-ARM spread[b]	2.11	1.28	0.65	0.89	0.28	0.27

a. Calculations based on the average 1-year and 3-year CMT during first four days of the survey week (1-year CMT: 8.87 percent in 1988 and 7.75 percent in 1989; 3-year CMT: 9.0 percent in 1988 and 7.78 percent in 1989).
b. Uses average conventional 30-year fixed-rate PMMS rate from PMMS survey of respective week (10.46 percent in 1988 and 9.74 percent in 1989).

Nearly half of the lenders surveyed were offering a 3-year ARM in late 1989, compared to about 60 percent in last year's survey. And as was the case last year, the 3/3 ARM was the most popular (offered by 60 percent of 3-year ARM lenders). The initial rate difference on 3/3 and 3/1 ARMs that existed last year (3/3 ARMs had a quarter percent higher rate than 3/1 ARMs) has largely vanished due to the flattening of the yield curve.

by Dana Martin; survey assistance from Laura Goodman