Mortgage Finance

Convertibles Hot, Discounts Not

Freddie Mac's eighth annual survey of Treasury-indexed adjustable-rate mortgage (ARM) lending programs reveals some important developments since a year ago.

First, fixed-rate convertibility has become even more popular with consumers, accounting for about two-thirds of ARM applications received by lenders, up from one-half last year. The low initial ARM rate, coupled with the ability to convert to fixed-rate for a nominal fee, has become an attractive marketing tool for lenders.

Second, teaser-rate lending has virtually disappeared from the market. The discount from the fully-indexed rate averaged only 1.46 percent for conforming 1-year ARMs, the lowest since our November 1987 survey.

Third, jumbo ARMs are offered by fewer lenders and have become more expensive relative to conforming ARMs. The increased cost and lessened availability of jumbo ARMs probably reflects shrinkage of the thrift industry over the past year, since thrifts had been major portfolio investors in this product. By contrast, the depth and liquidity of the conforming market, given the array of mortgage products eligible for purchase by Freddie Mac and Fannie Mae, has helped keep the supply of conforming mortgage funds plentiful for homebuyers.

Fourth, 3-year ARMs are less common than a year ago, with only two of every five ARM lenders offering a 3-year product. Competition from balloons and 15-year FRMs, which some lenders priced at or below 3-year ARMs, have made this product less attractive to consumers.

Fifth, the rate spread between conforming fixed-rate mortgages (FRMs) and 1-year ARMs has widened by half a percentage point, due largely to the steepening of the Treasury yield curve. The wide spread should increase the ARM share of originations in coming months.

A final caveat for consumers: shop around for your ARM. Holding points and the ARM margin constant, we found that ARM rates were three times more variable among lenders as FRM rates. For ARM borrowers, a more scrupulous search now could pay big rewards later.

Frank Nothaft, with assistance from Criss Peters

Characteristics of ARM Lending Programs (averages)

ARM Feature	1-Year ARMs Conforming	1-Year ARMs Jumbo	3-Year ARMs 3/3	3-Year ARMs 3/1
Initial Period Rate	6.46	6.90	8.07	7.70
Points	1.7	1.8	1.7	2.1
Margin	2.77	2.80	2.75	2.75
Fully-Indexed Rate[1]	7.92	7.95	8.87	7.90
Initial period discount	1.46	1.05	0.80	0.20
FRM-ARM spread[2]	2.30	1.86	0.69	1.06
Percent of ARM lenders offering	100	68	18	26

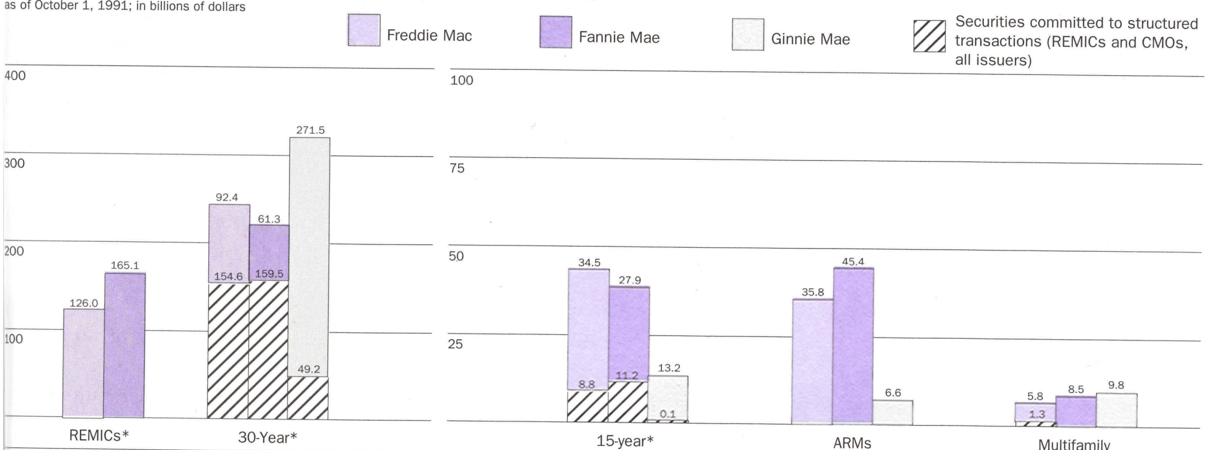
[1]Based on the value of the weekly average 1-year or 3-year CMT released November 4 (5.15 and 6.12 percent, respectively).

[2]Based on the average FRM commitment rate of 8.76 percent from the PMMS.

Note: The sample is limited to ARMs indexed to either the 1-year or the 3-year CMT. The survey was conducted the week beginning November 4. Since the PMMS canvasses programs offered by lenders, the actual characteristics of commitments made, as well as ARMs closed, is likely to differ from PMMS averages.

Outstanding Mortgage-Backed Security Balances by Issuer

as of October 1, 1991; in billions of dollars



*includes both 75-day and Gold

Sources: Freddie Mac, Fannie Mae, Ginnie Mae, Goldman Sachs