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# FREDDIE MAC SURVEY FINDS ADJUSTABLE RATE MORTGAGES (ARMs) REMAIN AN IMPORTANT CHOICE FOR BORROWERS

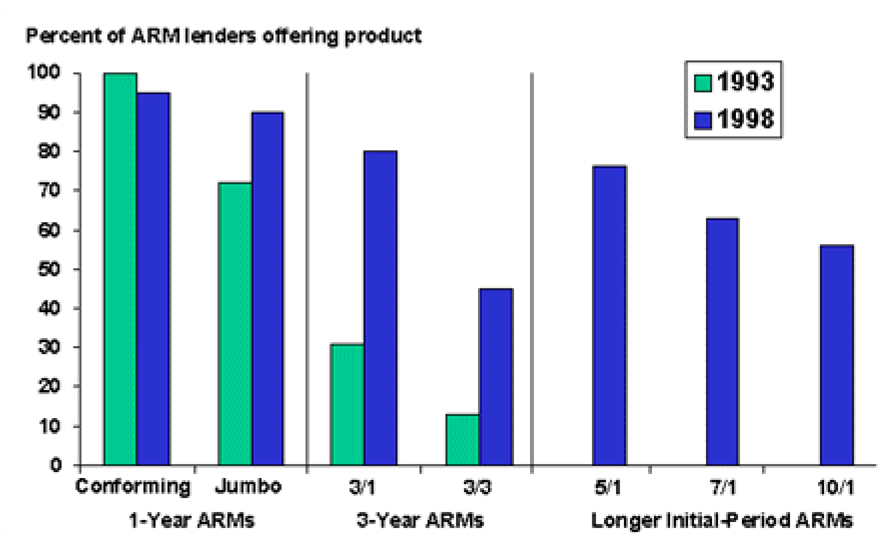
## Fifteenth Annual Survey reveals a longer initial adjustment period for ARMs

McLean, VA – Freddie Mac's 15th annual ARM survey finds that, since their introduction into the mortgage market in the early 1980s, adjustable-rate mortgages (ARMs) have continued to evolve, adapting to inevitable changes in market conditions and subsequent borrower needs. As a result, borrowers today can choose from a wide variety of ARM products.

Greater product selection has bolstered ARM origination volume even in the current low-interest-rate environment, which heightens the attractiveness of fixed-rate loans.

"Although homebuyers' preferences for one particular ARM product over another tend to shift with economic upturns and downswings, ARMs, in general, retain a significant market presence," said Frank Nothaft, deputy chief economist for Freddie Mac. "Freddie Mac estimates that conventional ARM originations for 1998 will total nearly $200 billion, or roughly 15 percent of all conventional originations for the year."

## EXHIBIT 1: Historical Market Penetration of ARM Products




The latest trend in ARM lending, according to the results of Freddie Mac's 15th annual ARM survey conducted in early November, is the increased availability of products with longer initial adjustment periods. Whereas five years ago 1-year ARM offerings dominated the ARM market, today longer-term options are plentiful (*Exhibit 1*). For example, today 8 out of 10 lenders offer a 3/1 ARM, for which the initial rate is fixed for three years before adjusting annually; five years ago only 3 of 10 lenders offered 3/1 ARMs.

Today, more financially savvy homebuyers seek more customized, and ultimately less costly, home-finance choices. Recognizing that ARMs can be more of a gamble than fixed-rate mortgages, particularly if interest rates rise dramatically, some homebuyers nonetheless are willing to accept the risk of future payment uncertainties. Longer extensions in the initial interest rate period allow ARM borrowers to defer the first adjustment from one year to as long as 10 years, giving them time to financially prepare for any impending interest-rate increase. "Furthermore," said Michael Schoenbeck, financial analyst for Freddie Mac, "homebuyers who plan a relatively short housing tenure or expect to refinance within a few years consider longer-term initial-adjustment ARMs especially favorable options, since the initial mortgage rate is less than for a fixed-rate loan."

# EXHIBIT 2: 1998 ARM Product Features

| . | **1-Year ARMs** | **3-Year ARMs** | **Longer Initial-Period ARMs** | | | | |
|---|---|---|---|---|---|---|---|
| . | **Conforming** | **Jumbo** | **3/1** | **3/3** | **5/1** | 7/1 | 10/1 |
| 1. Index | 4.46 | 4.46 | 4.46 | 4.50 | 4.46 | 4.46 | 4.46 |
| 2. Margin | 2.79 | 2.80 | 2.80 | 2.79 | 2.80 | 2.79 | 2.79 |
| 3. Fully-Indexed Rate (rows 1 + 2) | 7.25 | 7.26 | 7.26 | 7.29 | 7.26 | 7.25 | 7.25 |
| 4. Starting Rate | 5.48 | 5.60 | 6.19 | 6.44 | 6.44 | 6.62 | 6.77 |
| 5. Initial Discount [1] (rows 3 - 4) | 1.77 | 1.66 | 1.07 | 0.85 | 0.82 | 0.63 | 0.48 |
| 6. Points | 1.0 | 1.0 | 0.9 | 0.9 | 0.8 | 0.8 | 0.8 |
| 7. FRM - ARM Spread [2] | 1.41 | 1.96 | 0.70 | 0.45 | 0.45 | 0.27 | 0.12 |
| 8. Product Penetration (Percent) | 95 | 90 | 80 | 45 | 76 | 63 | 56 |

Note: The sample is limited to ARMs indexed to either the 1-year or the 3-year Constant Maturity Treasury (CMT) yield. Data were collected from 108 ARM lenders during the week ending November 6, 1998. The 3-year, 5-year, 7-year and 10-year ARM results are limited to conforming loans.

[1] Based on the value of the weekly average 1-year or 3-year CMT yield for the week-ending November 6, 1998.

[2] Based on the average 30-year conforming fixed-rate mortgage (FRM) commitment rate of 6.89 percent from Freddie Mac's Primary Mortgage Market Survey for the week-ending November 6, 1998 and the average 30-year jumbo FRM commitment rate of 7.56 percent from BanxQuote for the week-ending November 6, 1998.

Source: Freddie Mac

Ultimately, the savings adds up. A borrower opting for a 3/1 ARM over a 30-year fixed-rate loan, for example, can trim 0.7 percentage point off the starting mortgage rate (*Exhibit 2*). On a 30-year, $100,000 mortgage, this rate reduction translates to savings of $1,700 over the first three years of the loan.

Overall, a wide array of adjustment periods and lower initial rates make ARMs more financially attractive than fixed-rate loans to certain borrowers. The varying adjustment periods enable ARM borrowers to tailor their financing terms to suit not just their current but also their expected future income streams. Initial rates for ARMs tend to be lower than rates for fixed-rate loans because ARM lenders and borrowers share the interest-rate risk. Interest-rate and payment caps offer ARM borrowers some intermediate protection against rapid movements in the economy by limiting how high homebuyers' contract interest rates and monthly payments can adjust upward when interest rates skyrocket.

The variety of features that ARMs have also means, however, that the homebuyer can benefit by canvassing several lenders; Freddie Mac's survey found that the initial rates offered on 1-year ARMs were three times more variable than fixed rates, due to the wide array of product choices and market competition.

Freddie Mac is a stockholder-owned corporation chartered by Congress in 1970 to create a continuous flow of funds to mortgage lenders. By supplying lenders with the money to make mortgages and packaging the mortgages into marketable securities, Freddie Mac sustains a stable mortgage credit system and reduces the mortgage rates paid by homebuyers. Over the years, Freddie Mac has opened the doors for one in six homebuyers in America and two million renters.