ARMed and NOT Dangerous

Presented By

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Outline

1. What is an ARM – Adjustable Rate Mortgage
   a. Features
   b. Definitions
2. Common Indices
   a. CMT (Constant Maturity Treasury)
   b. LIBOR (London Interbank Offering Rates)
   c. COFI (Cost of Funds Index)
3. Calculating Your Rate Change
4. Questions One Should Ask
5. Advantages and Disadvantages of ARMS
6. ARM vs. Fixed?

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ARM – Adjustable Rate Mortgage

- An ARM is a loan with an interest rate that changes.
- With an adjustable-rate mortgage, the rate is typically fixed, or stays the same, for the first few years, and then it begins to adjust. Once the rate begins to adjust, the changes to your interest rate are based on the market, not your personal financial situation. Can be called HYBRID ARMS.

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Basic Features

- Loan Terms are determined at application and do not change during the loan term.
- Initial Interest Rate – The initial rate and payment amount on an ARM will remain in effect for a limited period.
- Adjustment Period – The period between rate changes is called the adjustment period.
  - Ex: A loan with an adjustment period of one year is called a one year ARM.

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Basic Features Continued

- Index –The index is an economic indicator, it reflects general Market conditions.
- Margin – Amount Charges over the index to determine the new rate. A LOWER margin means a lower rate over time.
- Rate Caps – Rate Caps place a limit on the amount your interest rate can increase.
  - Initial
  - Periodic
  - Life

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Common Indices

- **1-Year Constant Maturity Treasury index (1 Yr CMT)**
  This is the most widely used index. Roughly half of all ARMs are based on this index. It's used on ARMs with annual rate adjustments. It is also referred to as the 1-Year Treasury Bill (1Yr T-Bill), the 1-Year Treasury Security (1Yr T-Sec), or the 1-Year Treasury Spot index.

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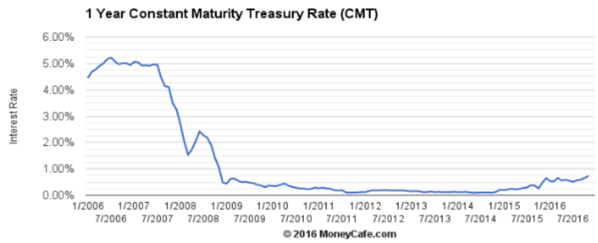
History of CMT



1 Year Constant Maturity Treasury Rate (CMT)

Month	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Jan	4.45%	5.06%	2.71%	0.44%	0.35%	0.27%	0.12%	0.15%	0.12%	0.20%	0.54%
Feb	4.68%	5.05%	2.05%	0.62%	0.35%	0.29%	0.16%	0.16%	0.12%	0.22%	0.53%
Mar	4.77%	4.92%	1.54%	0.64%	0.40%	0.26%	0.19%	0.15%	0.13%	0.25%	0.66%
Apr	4.90%	4.93%	1.74%	0.55%	0.45%	0.25%	0.18%	0.12%	0.11%	0.23%	0.56%
May	5.00%	4.91%	2.06%	0.50%	0.37%	0.19%	0.19%	0.12%	0.10%	0.24%	0.59%
Jun	5.16%	4.96%	2.42%	0.51%	0.32%	0.18%	0.19%	0.14%	0.10%	0.28%	0.55%
Jul	5.22%	4.96%	2.28%	0.48%	0.29%	0.19%	0.19%	0.12%	0.11%	0.30%	0.51%
Aug	5.08%	4.47%	2.18%	0.46%	0.26%	0.11%	0.18%	0.13%	0.11%	0.38%	0.57%
Sep	4.97%	4.14%	1.91%	0.40%	0.26%	0.10%	0.18%	0.12%	0.11%	0.37%	0.59%
Oct	5.01%	4.10%	1.42%	0.37%	0.23%	0.11%	0.18%	0.12%	0.10%	0.26%	0.66%
Nov	5.01%	3.50%	1.07%	0.31%	0.25%	0.11%	0.18%	0.12%	0.13%	0.48%	0.74%
Dec	4.94%	3.26%	0.49%	0.37%	0.29%	0.12%	0.16%	0.13%	0.21%	0.65%	

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Indices Continued

- **London Inter Bank Offering Rates (LIBOR)**

London Inter Bank Offering Rate (LIBOR) is an average of the interest rate on dollar-denominated deposits, also known as Eurodollars, traded between banks in London. The Eurodollar market is a major component of the International financial market. London is the center of the Euromarket in terms of volume. The LIBOR is an international index which follows the world economic condition. It allows international investors to match their cost of lending to their cost of funds. The LIBOR compares most closely to the 1-Year CMT index and is more open to quick and wide fluctuations than the COFI rate.

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History of Libor (London Interbank)

1 Year LIBOR

Month	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Jan	4.94120%	5.44140%	4.22375%	2.00375%	0.98438%	0.78094%	1.12805%	0.84350%	0.58310%	0.62880%	1.17800%
Feb	5.15260%	5.33280%	2.84938%	1.97500%	0.84625%	0.78125%	1.09570%	0.78100%	0.56540%	0.62090%	1.13975%
Mar	5.24760%	5.20090%	2.70875%	2.11938%	0.83938%	0.79025%	1.05980%	0.75150%	0.55330%	0.67960%	1.17875%
Apr	5.42170%	5.29670%	2.48625%	1.97188%	0.92000%	0.78250%	1.04850%	0.73150%	0.55810%	0.69420%	1.21040%
May	5.41390%	5.38850%	3.07875%	1.87688%	1.01563%	0.76100%	1.04720%	0.70450%	0.54900%	0.70525%	1.22950%
Jun	5.76600%	5.40480%	3.16375%	1.60000%	1.20406%	0.72950%	1.06920%	0.68920%	0.53440%	0.74970%	1.33740%
Jul	5.59100%	5.42563%	3.31063%	1.60625%	1.17313%	0.73350%	1.06800%	0.68565%	0.54510%	0.77150%	1.23025%
Aug	5.45010%	5.24500%	3.25250%	1.49750%	1.03669%	0.76025%	1.05350%	0.67319%	0.57960%	0.82835%	1.43210%
Sep	5.29850%	5.27500%	3.20688%	1.33000%	0.84306%	0.80000%	1.03200%	0.66710%	0.56560%	0.84330%	1.55711%
Oct	5.33480%	4.90125%	3.96250%	1.26375%	0.77775%	0.86489%	0.97300%	0.62940%	0.58020%	0.85110%	1.55178%
Nov	5.24390%	4.63750%	3.17375%	1.19938%	0.76219%	0.93561%	0.87550%	0.60260%	0.55380%	0.86840%	1.57511%
Dec	5.31390%	4.45750%	2.76625%	1.01750%	0.78656%	1.07106%	0.86000%	0.57800%	0.56460%	0.98060%	1.63900%

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Indices Continued

11th District Cost of Funds Index (COFI)

- This index reflects the weighted-average interest rate paid by 11th Federal Home Loan Bank District savings institutions for savings and checking accounts, advances from the FHLB, and other sources of funds. The 11th District represents the savings institutions headquartered in Arizona, California and Nevada. Since the largest part of the Cost Of Funds index is interest paid on savings accounts, this index lags market interest rates in both uptrend and downtrend movements. As a result, ARMs tied to this index rise (and fall) more slowly than rates in general, which is good for you if rates are rising but not good for you if rates are falling.

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Recent History of US Prime Rate

Prime Rate

Month	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Jan-1	7.25%	8.25%	7.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Feb-1	7.50%	8.25%	6.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Mar-1	7.50%	8.25%	6.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Apr-1	7.75%	8.25%	5.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
May-1	7.75%	8.25%	5.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Jun-1	8.00%	8.25%	5.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Jul-1	8.25%	8.25%	5.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Aug-1	8.25%	8.25%	5.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Sep-1	8.25%	8.25%	5.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Oct-1	8.25%	7.75%	5.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Nov-1	8.25%	7.50%	4.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%
Dec-1	8.25%	7.50%	4.00%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.25%	3.50%

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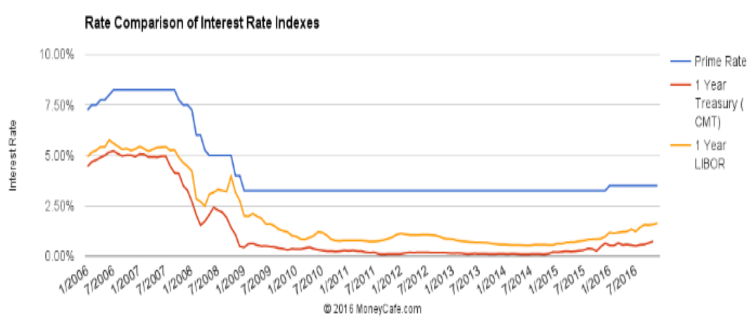
Rate Comparison Prime/Libor/T-Bill(CMT)



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Calculating Your Rate Change

- To calculate your new interest rate when it's time for it to adjust, lenders use two numbers: the **index** and the **margin.**
- The lender decides which index your loan will use when you apply for the loan, and this choice generally won't change after closing**.** The most commonly used index for mortgages is the one-year LIBOR, which stands for the London Inter-Bank Offer Rate. You can look up the current LIBOR rates in major newspapers such as the Wall Street Journalor on financial websites such as bankrate.com**.**

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ARM Demonstration

- Example 7/1 ARM
- Start Rate 3.625%
- Caps 5/2/5
- Margin 2.25
- Index 1 year LIBOR

- Years 1-7 Rate is FIXED and Fully Amortizing at 3.625

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Subsequent Years

- Year 8: Initial Cap is 5%
- Max Rate in Year 8 is 8.625% (3.625% + 5% Initial Cap)
- Actual Rate is 1 year Libor (at that time) PLUS 2.25% margin (round up to .125%)
- If Libor is 1.654 + 2.25% Margin = 3.904 rounded to 4% rate for year 8

- Year 9: If Year 8 Rate is 4% the Max Rate is 6% (4% + 2% Adjustment Cap)

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Questions to Ask

- **Know how your ARM adjusts.** Before taking out an adjustable rate mortgage, find out:
  - How high your interest rate and monthly payments can go with each adjustment
  - How frequently your interest rate will adjust
  - How soon your payment could go up
  - If there is a cap on how high your interest rate could go
  - If there is a limit on how low your interest rate could go
  - If you will still be able to afford the loan if the rate and payment go up to the maximums allowed under the loan contract

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Advantages of ARMs

1. Are planning to move in a few year (before the end of the introductory fixed-rate period) and therefore aren't concerned about possible rate increases
2. Expect your income to rise enough in the coming years to cover any increase in payments resulting from an increase in the interest rate
3. Want a lower initial monthly payment than a fixed-rate mortgage usually offers, may qualify for more house/loan
4. Think interest rates may go down in the future.

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Disadvantages of ARMs

1. Interest rates will increase in a rising rate environment
2. An increase in rates will increase your payment amount, which may not keep pace with an increase you may have in income
3. Payments are not predictable (except for worse case scenario)
4. Payment shock if rates/payment rise sharply
5. Negative amortization (if part of your loan program.)

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Fixed Rate Mortgage

Features: Fixed Rate Mortgage
Your interest rate and monthly principal and interest payments remain the same for the life of your loan.
Available in a variety of loan term options.
You may be able to add extra features such as a temporary buy down.

Benefits: Predictable monthly P&I payments allow you to budget more easily.
Protection from rising interest rates for the life of the loan, no matter how high interest rates go.
May be a good choice if you plan to stay in your home for a long time.

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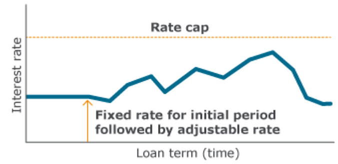

Adjustable Rate Mortgage

Features: Your interest rate and monthly principal and Interest payments (P&I) payments remain the same for an initial period of 5, 7, or 10 years, then adjust annually.
Loans available in a variety of longer terms.
Includes an interest rate cap that sets a limit on how high your interest rate can go.

Benefits: Typically ARMs have a lower initial interest rate than on a fixed-rate mortgage. The interest rate cap limits the maximum amount your P&I payment may increase at each interest rate adjustment and over the life of the loan. May provide flexibility if you expect future income growth or if you plan to move or refinance within a few years.

Considerations: Monthly principal and interest payments may increase when the interest rate adjusts.
Your monthly principal and interest payments may change every year after the initial fixed period is over.

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Fixed Rate vs. ARM

Sales Price: $400,000 Loan: $380,000
Fixed Mortgage Rate: 3.99%
Adjustable Rate Mortgage: 3.25%

	Fixed P&I	ARM P&I	Monthly Difference	Cumulative Savings	Accum. Equity Fixed/Arm
Year 1	$1,811.99	$1,653.78	$158.21	$1,899.52	$904.45 / $904.45
Year 2	$1,811.99	$1,653.78	$158.21	$2,797.04	$883 / $1,787.45
Year 3	$1,811.99	$1,653.78	$158.21	$5,695.56	$858.77 / $2,646.22
Year 4	$1,811.99	$1,653.78	$158.21	$7,594.08	$831.55 / $3,477.77
Year 5	$1,811.99	$1,653.78	$158.21	$9,492.60	$801.22 / $4,278.99
Year 6	$1,811.99	$1,653.78	$158.21	$11,391.12	$767.51 / $5,046.50
Year 7	$1,811.99	$1,653.78	$158.21	$13,289.24	$730.24 / $5,776.74

Principal Balance on 30 Year Fixed at end of Year 7 is $326,950
Principal Balance on 7 Year ARM at end of Year 7 is $321,173

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Questions

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