

**For Immediate Release**

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# **DEMAND FOR ARM LOANS INCREASES AS MORTGAGE RATES RISE AND LENDERS OFFER NEW PRODUCTS**

## **Nearly One-Third of All Mortgages in 1999 Were ARMs**

McLean, VA – According to Freddie Mac’s 16th Annual ARM Survey much of the increase in ARM share in 1999 can be attributed to the rising expense of fixed-rate loans, an increase in low introductory pricing on ARMs, and the wide availability of an array of ARM products across lenders. Currently, ARM lending represents about a third of all new single-family loans, according to industry sources.

“In 1998, ARMs constituted only 8 percent of the conventional home-purchase lending market,” said Frank Nothaft, deputy chief economist for Freddie Mac. “Since then, fixed-rate mortgages have risen about a percentage point while first-year rates on ARMs have risen less, largely due to an increase in the initial-period discount on ARMs of about a quarter percent, according to Freddie Mac’s survey. As a consequence, the ARM share in the conventional market has rebounded to 30 percent, the highest share in three years.”

ARMs tend to carry lower interest rates than fixed-rate mortgages because the mortgage rate is calculated based on short-term interest rates, which are often lower than long-term rates. The difference in interest rate and payment outlay between a fixed-rate mortgage and an ARM can be considerable in the first year. For instance, in November this difference amounted to about 1.3 percentage points for a conforming 1-year ARM, according to Freddie Mac’s 16th Annual ARM Survey. Such a savings amounts to \$1,080 over the initial year, for \$100,000 conforming mortgage loan. Alternatively, homebuyers can save \$1,618 over the first three years with a 3/1 ARM and \$1,846 over the first five years with a 5/1 ARM.

Compared to last year, slightly more lenders offered the 5/1 ARM option. Moreover, over the last few years, homebuyers have become more financially sophisticated allowing lenders to add more options to their ARM menus, namely through longer initial-rate periods

According to the latest data collected by the Federal Housing Finance Board, the 5/1 ARM has become the second most popular ARM financing option (excluding the miscellaneous other hybrid ARMs category).

5/1 ARMs are attractive for multiple reasons. To start, the initial interest-rate discount keeps the monthly payments below fixed-rate mortgage loans. Furthermore, if new homebuyers expect an increase in their incomes over the next five years, the upcoming interest-rate adjustment may not be of great consequence. Recent developments in technology -- in automated underwriting systems such as Freddie Mac's Loan Prospector, in particular -- make refinancing a loan both quicker and cheaper. This allows homeowners easy access to refinancing their current housing debts when interest rates fall. Finally, with the initial five-year fixed-rate period, a homebuyer can balance their expected increases in income with an ever-changing interest-rate environment over a manageable time period.

This year's survey included information on FHA-insured ARMs for the first time. FHA ARMs had a slightly higher interest rate than conforming 1/1 ARMs in the survey, reflecting the fact that the FHA product has one-percent annual interest rate caps compared with the two-percent caps common in the conventional market. In exchange for the greater interest-rate risk that investors accept, FHA ARMs carry a slightly higher initial rate.

Freddie Mac is a stockholder-owned corporation chartered by Congress in 1970 to create a continuous flow of funds to mortgage lenders in support of homeownership and rental housing. Freddie Mac purchases mortgages from lenders and packages them into securities that are sold to investors. Over the years, Freddie Mac has opened the doors for one in six homebuyers and two million renters across America.



## Various ARM Product Features in 1999

	1-Year ARMs			3-Year ARMs		Longer Initial-Period ARMs		
	1/1 Conforming	1/1 Jumbo	1/1 FHA	3/1	3/3	5/1	7/1	10/1
Loan Terms	----- <i>Percentage Points</i> -----							
Index Rate	5.56	5.56	5.56	5.56	5.91	5.56	5.56	5.56
Margin	2.78	2.76	2.76	2.79	2.79	2.79	2.77	2.77
Fully-Indexed Rate	8.34	8.32	8.32	8.35	8.70	8.35	8.33	8.33
Initial Discount	1.99	1.81	1.88	1.32	1.50	1.11	0.82	0.70
Initial Interest Rate	6.35	6.51	6.44	7.03	7.20	7.24	7.51	7.63
Fees and Points	1.1	1.0	1.0	1.1	1.0	1.1	1.0	1.1
Fixed-Adjustable								
Rate Spread	1.34	1.54	1.54	0.66	0.49	0.45	0.18	0.06
Product Concentration	96	88	74	75	32	79	61	52

Notes: 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 103 ARM lenders during the week ending November 19, 1999. The 3-year, 5-year, 7-year and 10-year ARM results are limited to conforming loans. The initial discount is based on the value of the weekly average 1-year or 3-year CMT yield for the week ending November 19, 1999. The rate spread is based on the average 30-year conforming fixed-rate mortgage (FRM) commitment rate of 7.69 percent from Freddie Mac's Primary Mortgage Market Survey for the week ending November 19, 1999, and the average 30-year Jumbo FRM and average 30-year FHA FRM commitment rates of 8.05 percent and 7.98 percent, respectively, as reported by BanxQuote for the week ending November 19, 1999.