Low-Rate Financing and Hybrids Are Features of Today's ARM Market

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MCLEAN, VA--(Marketwired - Jan 22, 2015) - Freddie Mac (OTCQB: FMCC) today released the results of its 31st Annual Adjustable-Rate Mortgage (ARM) Survey of prime loan offerings, which was conducted January 5 to January 8, showing ARM initial-period rates have decreased since last year and hybrids dominate lenders' ARM offerings. More information is available at the January 2015 Treasury-Indexed ARM Features table.

News Facts

- Interest Rates Lower. The initial interest rate was lower for all ARM products compared to last year. For example, for a one-year, 5/1 or 10/1 Treasury-indexed ARM, the average initial rate was 2.39 percent, 2.98 percent, and 3.71 percent, respectively, down 0.2 percentage points for the one-year and 5/1 products and 0.3 percentage points for the 10/1 ARM. The larger decline for the 10/1 ARM reflects the drop in longer-term interest rates over the past year.

- Hybrids Are Hot. Hybrid ARMs continued to be the most popular loan product offered by lenders and chosen by ARM borrowers. Hybrid ARMs have an extended initial fixed-rate period -- generally three to ten years -- and then adjust annually thereafter. Nearly all of the ARM lenders participating in the survey offered a hybrid. The 5/1 hybrid (a five-year fixed-rate initial period before the rate resets annually) was by far the most common, followed by the 7/1, 3/1 and 10/1. Far less common were ARMs where the repricing frequency was fixed for the life of loan, such as a one-year adjustable, a 3/3 ARM (which adjusts once every three years), or a 5/5 ARM (which adjusts every fifth year).

- Substantial Payment Savings During Initial Years. In early January 2015, the interest rate savings for the 5/1 hybrid ARM with a 30-year term -- the most common ARM offered in today's market -- compared to the 30-year fixed-rate mortgage amounted to 0.75 percentage points. For a $250,000 loan, the monthly principal and interest payment on a 5/1 hybrid would be about $103 less than on the 30-year fixed-rate loan over the first five years of the loan.

- Treasury-Indexed: Lower Index, Higher Margin. Among the unique 84 ARM lenders surveyed, 70 offered Treasury-indexed ARMs and 14 offered London Interbank Offered Rate (LIBOR)-indexed ARMs; generally, community and regional lenders were more likely to offer Treasury-indexed ARMs while large, national lenders offered LIBOR-based ARMs. Thus, reflecting the fact that large financial institutions have many branches, the LIBOR-based product accounted for roughly one-half of ARM originations. Treasury-indexed ARMs generally had a lower index (about 0.4 percentage points lower) than LIBOR-indexed ARMs, a similar initial interest rate, and a higher margin (about 0.5 percentage points higher).

Quotes:

Attributed to Frank Nothaft, vice president and chief economist, Freddie Mac.

- "Low-rate financing and hybrids are not only features of the automobile market, but are also prominent in the ARM products offered by lenders. Hybrid ARMs include an extended initial period where the interest rate is fixed and lower than for a 30-year fixed-rate loan. Because consumers who choose an ARM often are taking out a higher-balance loan, their payment savings can add up over the first few years of the loan. The average loan size for a conventional ARM for home purchase was more than $400,000 during 2014 and about double the size of an average fixed-rate loan, according to data from the Federal Housing Finance Agency. On a $400,000 loan, a family would save about $9,000 during the first five years of a 5/1 hybrid compared with a 30-year fixed-rate loan, based on interest rates collected in our survey.

- "Today's low mortgage rates will not be around forever. Even a majority of the Federal Reserve's policy-making committee expect interest rates to rise by year-end. Higher rates on both ARM and fixed-rate products, and further gains in home values, could lead more borrowers to opt for an ARM. During 2014, ARMs comprised about 10 percent of home-purchase loans in the conventional market, according to the Federal Housing Finance Agency. If fixed-rate loans become more expensive and home values rise further, we expect more consumers to take another look at ARMs and project the ARM share rising to 12 percent of the conventional home-purchase market in 2015."

Freddie Mac was established by Congress in 1970 to provide liquidity, stability and affordability to the nation's residential mortgage markets. Freddie Mac supports communities across the nation by providing mortgage capital to lenders. Today Freddie Mac is making home possible for one in four home borrowers and is one of the largest sources of financing for multifamily housing. Additional information is available at FreddieMac.com, Twitter @FreddieMac and Freddie Mac's blog FreddieMac.com/blog.