INTRODUCTORY RATE ARM'S

Most adjustable rate loans (ARMs) have a low introductory rate or start rate, some times as much as 5.0% below the current market rate of a fixed loan. This start rate is usually good from 1 month to as long as 10 years. As a rule the lower the start rate the shorter the time before the loan makes its first adjustment.

Index - The index of an ARM is the financial instrument that the loan is "tied" to, or adjusted to. The most common indices, or, indexes are the 1-Year Treasury Security, LIBOR (London Interbank Offered Rate), Prime, 6-Month Certificate of Deposit (CD) and the 11th District Cost of Funds (COFI). Each of these indices move up or down based on conditions of the financial markets.

Margin - The margin is one of the most important aspects of ARMs because it is added to the index to determine the interest rate that you pay. The margin added to the index is known as the fully indexed rate. As an example if the current index value is 5.50% and your loan has a margin of 2.5%, your fully indexed rate is 8.00%. Margins on loans range from 1.75% to 3.5% depending on the index and the amount financed in relation to the property value.

Interim Caps - All adjustable rate loans carry interim caps. Many ARMs have interest rate caps of six-months or a year. There are loans that have interest rate caps of three years. Interest rate caps are beneficial in rising interest rate markets, but can also keep your interest rate higher than the fully indexed rate if rates are falling rapidly.

Payment Caps - Some loans have payment caps instead of interest rate caps. These loans reduce payment shock in a rising interest rate market, but can also lead to deferred interest or "negative amortization". These loans generally cap your annual payment increases to 7.5% of the previous payment.

Lifetime Caps - Almost all ARMs have a maximum interest rate or lifetime interest rate cap. The lifetime cap varies from company to company and loan to loan. Loans with low lifetime caps usually have higher margins, and the reverse is also true. Those loans that carry low margins often have higher lifetime caps.

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