ADJUSTABLE / FLOATING RATE MORTGAGE LOANS

Interest Rate Changes: **Indexed** to other market **Interest Rates** (plus a **Margin**).

Index: **LIBOR** (London Inter Bank Offered Rate), **US Treasuries**, **COFI** (11th district Cost of Funds Index), **Prime**. The **Index** can be 6 months, 1 year or another rate series.

Margin: **Lender's Profit Margin** or spread (fixed for the loan term) over the **Index**.

Composite Rate: The **Index + Margin** is the **Composite Interest Rate** on the **Loan**.

Reset Dates: When the **Interest Rate Changes** (usually every six months or 1 year).

Caps and Floors: **Caps** are the **Maximum** and **Floors** are the **Minimum** allowed **Periodic** and/or **Lifetime** adjustments of the **Interest Rate** or **Loan Payment** amount. **Floors** are ineffective if **Borrowers** can refinance with no **Prepayment Penalty**.

Loan Terms: Are generally the same terms as with **Fixed Rate Loans**, other than the interest rate changes, and include **Assumable** or **"Due on Sale"**, **Recourse** or **Non-Recourse**, **Prepayment** or **Lockout**, **Assignment**, **Default** and **Acceleration**.

Loan Fees and Costs: As with **Fixed Rate Loans**, **Origination Fees**, **Points** and **Costs** may be charged to the **Borrower** to increase the **Effective Yield** to the **Lender**.

Interest Only or Amortizing: As with **Fixed Rate Loans**, **ARMs** are usually **Fully Amortizing**, but can also be written as **Interest Only** or **Partially Amortizing**.

Negative Amortization: If the **Loan Payment** required is less than the amount of **Accrued Interest** then due on the **Loan** because of a **Payment Cap**, there will be **Negative Amortization**. **Interest Rate Caps** do not cause **Negative Amortization.**

Teaser Rate: Initial **Interest Rate** on the **Loan**, often far below the **Composite Rate.**

Payment Shock: When the **Interest Rate** fully adjusts to the current **Composite Rate,** the new **Loan Payment** amount is often substantially higher than the **Teaser Rate**.

Interest Rate Risk: Because **ARM Interest Rates** adjust **Periodically**, **Interest Rate Risk** is higher for the **Borrower** and lower for the **Lender**. The shorter the time interval between **Reset Dates**, the higher the **Risk** for the **Borrower** and lower for the **Lender**.

Default Risk: Because the **Interest Rate** adjusts **Periodically**, the potential for future **Rate** increases elevates the **Risk** of a **Default** by the **Borrower** leading to **Foreclosure.**

Hybrid ARMs: **3/1**, **5/1**, **7/1** or **10/1** are **Fixed Rate Loans** for the first 3, 5, 7 or 10 years, then become **Adjustable Rate Loans** with annual **Interest Rate Reset Dates**.

Conversion Option: The right of the **Borrower** to convert the **Loan** from an **ARM** to a **Fixed Rate Loan** at a specified future date, usually with a **Fee** paid to the **Lender**.