



Important Facts About Your Adjustable Rate Mortgage

Whether you are buying a house or refinancing your mortgage, this information can help you decide if an adjustable rate mortgage (ARM) is right for you. ARMs can be complicated. If you do not understand how they work, you should not sign any loan contracts, and you might want to consider other loans.

With an ARM, the interest rate on your loan is not fixed. Instead, it changes over time according to a formula - typically, a base interest rate (index) plus a certain percent (margin) (for example, the Prime Rate plus 3 percent). So, if the base interest rate increases, your interest rate and monthly payment will also increase.

Some specific terms of your ARM loan are explained below.

► **Your loan will have a reduced initial interest rate.**

Some ARMs have a reduced interest rate (start rate) for a short period of time - for example, the first two years of the loan. This rate is less than the index plus margin rate. This means that your interest rate and monthly payments will be lower than normal for the first two years. However, your interest rate and monthly payment may increase significantly when that period is over - even if market rates stay the same. And, your interest rate and monthly payment will increase even more if market rates rise.

► **Your monthly payment will not include an amount to cover taxes and insurance.**

In some mortgages, your monthly payment includes both principal and interest and an amount to cover real estate taxes and home insurance - and your lender pays your taxes and insurance out of these funds. In other mortgages, your monthly payment covers only principal and interest, and you are responsible for paying real estate taxes and insurance premiums when the bills arrive. When you are comparing mortgages, or deciding whether you can afford a mortgage, you need to consider whether or not the monthly payment includes an amount to cover estimated taxes and insurance.

► **You will be required to pay a prepayment penalty if you pay off your loan more than 60 days before the initial interest rate is adjusted. The amount of the penalty will be a percentage of the outstanding balance of the loan.**

Some ARMs require you to pay a large prepayment penalty if you sell your home or refinance during the first few years of the loan. A prepayment penalty can

make it difficult, or very expensive, to sell your home or refinance - which you may need to do if your interest rate, and therefore your payment, is about to increase significantly.

► **Your loan will have a balloon payment.**

Most mortgages are set up so that you pay off the loan gradually by the monthly payments that you make over the loan term (for example, 30 years). Some ARMs, however, are set up with "balloon payments" - you make the same monthly payments that you would for a 30-year loan, but after a shorter period of time (for example, 10 years), the entire remaining balance of the loan is due. When the balloon payment is due you will usually need to refinance your loan to pay it, or sell your home if you cannot refinance the loan.

► **Your loan will have a higher price because of reduced documentation.**

"Reduced documentation" or "stated income" loans usually have higher interest rates or other costs compared to "full documentation" loans available if you document your income, assets, and liabilities. These higher costs can be substantial.

SAMPLE MORTGAGE COMPARISON <i>(Not actual loans available)</i>		
Sample Loan Amount \$200,000 - 30-Year Term - Interest Rates For Example Purposes Only		
	Fixed Rate Mortgage 7.5%	Reduced Initial Rate "2/28" ARM 7% for two years, then adjusting to variable rate; 10% maximum rate in Year 3; 11.5% maximum rate in Year 4; 13% maximum rate in Years 5-30
	REQUIRED MONTHLY PAYMENTS (includes \$200 per month for real estate tax and insurance escrow)	
Years 1-2	\$1,598	\$1,531
Year 3 - if rates don't change	\$1,598	\$1,939
Year 4 - if rates don't change	\$1,598	\$2,152
Year 5 - if rates rise 2%	\$1,598	\$2,370