Understanding Adjustable Rate Mortgages

July 2018
Agenda

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Adjustable Rate Mortgage (ARM)

Definition - A mortgage that does not have a fixed interest rate. The rate changes during the life of the loan based on movements in an index rate, such as the rate for Treasury securities or the Cost of Funds Index. ARMs usually offer a lower initial rate than fixed-rate loans. The interest rate fluctuates over the life of the loan based on the market conditions, but the agreement generally sets maximum and minimum rates. When interest rates increase, generally the loan payments increase, and when interest rates decrease, the monthly payment may decrease.

www.cfpb.gov
ARM Characteristics

Adjustable Rate Mortgages, or ARM’s, have an interest rate that increases or decreases over the life of the loan, based upon the interest rate environment.

Characteristics of an ARM include:

- A starting interest rate that is generally lower than the rate offered on a fixed rate mortgage
- An interest rate that is tied to a particular index
- Caps that are established for the:
  - Adjustment period (interest rate cap)
  - Life of the loan (lifetime cap)
  - Payment (payment cap)
  - These caps limit the amount the interest rate and/or payment may change
- Uncertainty for the borrower who does not know how much their payment will change at each adjustment
- ARM’s may offer a lower initial interest rate than a fixed rate program
- Potential for increased delinquencies, due to payment adjustments
- Various types of ARM’s are available, depending on the adjustment period. For example, a 1-year ARM adjusts yearly.
## ARM Components

<table>
<thead>
<tr>
<th>Index</th>
<th>Changes in the interest rate are governed by a financial index. The lender chooses an index for each ARM product that is out of their influence. Common indexes include: Treasury Securities, Costs of Funds or the LIBOR index.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Margin</td>
<td>This is a predetermined amount that is added to the index to determine the fully indexed interest rate. Margins are generally fixed for the term of the loan.</td>
</tr>
<tr>
<td><strong>Fully Indexed Accrual Rate (FIAR)</strong></td>
<td>This is the index plus the margin. This is how we calculate what the rate is at the time of adjustment.</td>
</tr>
<tr>
<td>Discount/Short Fall</td>
<td>A one-time reduction to make the initial rate competitive. The result is also called the “teaser rate.” This is the Start Rate. The amount of the discount is decided by the investor.</td>
</tr>
<tr>
<td>Initial Rate/Start Rate Teaser Rate</td>
<td>What the lender charges for the first period of the ARM. It is the FIAR minus the discount.</td>
</tr>
<tr>
<td><strong>Periodic Adjustment Cap</strong></td>
<td>This limits the amount the interest rate can adjust up or down from one adjustment period to the next after the first adjustment. Also known as the subsequent adjustment cap. Usually 1% or 2%.</td>
</tr>
<tr>
<td>Initial Adjustment Cap</td>
<td>This limits the amount the interest rate can adjust up or down on the first adjustment. Usually 5% or 6%. Not all loans have a different Initial adjustment cap than the periodic adjustment cap.</td>
</tr>
<tr>
<td>Lifetime Cap</td>
<td>Limits the amount of upward interest rate adjustment over the full term of the loan. Usually 5% or 6%.</td>
</tr>
<tr>
<td>Negative Amortization</td>
<td>Occurs when the interest on a loan is accruing at a faster rate than it is being repaid.</td>
</tr>
</tbody>
</table>
ARM Features

Conversion Clause
– A provision in some ARM’s that allows the consumer to change the ARM to a fixed-rate loan at some point during the term. Conversion is usually allowed at the end of the first adjustment period. At the time of the conversion, the new fixed rate is generally set at one of the rates then prevailing for fixed-rate mortgages. The conversion feature may be available at extra cost.


https://www.consumerfinance.gov/consumer-tools/mortgages/key-terms/
ARM Indexes

One-Year Treasury Index – H15 – Federal Reserve

The One Year Treasury Bill is one of the primary borrowing or debt instruments of the Treasury Department of the United States. This Bill is used for short term borrowing or financing by the Treasury Department for the United States Government. This is the most common index in the Eastern U.S.

LIBOR – London Interbank Offered Rate

LIBOR is the rate on dollar-denominated deposits, also known as Eurodollars, traded between banks in London. The index is quoted for one, three and six-month periods, and for one year periods as well. LIBOR is the base interest rate paid on deposits between banks in the Eurodollar market. A Eurodollar is a dollar deposited in a bank in a country where the currency is not the dollar. The Eurodollar market has been around for 40 years and is a major component of the international financial market. London is the center of the Euromarket in terms of volume. LIBOR as quoted in the Wall Street Journal is an average of rate quotes from FIVE major banks: Bank of America, Barclays, Bank of Tokyo, Deutsche Bank and Swiss Bank. This is commonly used as an index for LIBOR based loans. The most common quote for mortgages is the six-month LIBOR. LIBOR most closely tracks the One Year Treasury Security Index.

On July 27, 2017, the U.K. Financial Conduct Authority (FCA) announced its intention to phase out LIBOR (London Interbank Offered Rate) by the end of 2021.

The Federal Reserve has tasked the Alternative Reference Rate Committee (ARRC) with the responsibility of the transition from U.S. Dollar LIBOR to a new benchmark replacement rate. ARRC set up an index called the Broad Treasury Financing Rate (BTFR). The BTFR rate contains a broad set of US treasury market based financing transactions, also known as repo transactions. However, it is not likely that this will serve as a replacement for ARM indexes in the future.
ARM Indexes

COFI – Cost of Funds Index
The Eleventh District Cost of Funds is the most prevalent index in the Western U.S. The COFI index, which is a weighted monthly average, has been published since 1981 by the San Francisco Federal Home Bank (The Eleventh District). The funds used for the calculation are the liabilities at the District’s Savings Institutions, which include deposits, borrowings from the FED and all other borrowings. The interest paid on these funds is the cost for these funds. The word “weighted” is used for this type of index, because the above referenced components are used to determine the blended or weighted rate. It is the least volatile of all the indices.

1 Year MTA
This index is an average of the monthly one-year treasury adjusted to constant maturity for the past 12 months. Yields on Treasury Securities at constant maturity are determined by the U.S. Treasury from the daily yield curve, which is based on the closing market-bid yields on actively traded Treasury securities in the over-the-counter market.

Federal Funds Rate
This is the interest rate at which banks and other depository institutions lend money to each other, usually on an overnight basis. Like the federal discount rate, the federal funds rate is used to control the supply of available funds, and hence, inflation and other interest rates. Raising the rate makes it more expensive to borrow. This lowers the supply of available money and increases the short-term interest rates.
# ARM Indexes

<table>
<thead>
<tr>
<th></th>
<th>Latest</th>
<th>Yesterday</th>
<th>Week Ago</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal Funds Rate</td>
<td>1.42%</td>
<td>1.42%</td>
<td>1.42%</td>
</tr>
<tr>
<td>Discount Rate</td>
<td>2.00%</td>
<td>2.00%</td>
<td>2.00%</td>
</tr>
<tr>
<td>Overnight Libor (1 day delay)</td>
<td>1.45%</td>
<td>1.45%</td>
<td>1.45%</td>
</tr>
<tr>
<td>Fannie Mae 30/60</td>
<td>4.06%</td>
<td>4.05%</td>
<td>4.09%</td>
</tr>
<tr>
<td>6 Month Libor (1 day delay)</td>
<td>2.32%</td>
<td>2.30%</td>
<td>2.24%</td>
</tr>
<tr>
<td>10 Year Treasury Security</td>
<td>2.81%</td>
<td>2.84%</td>
<td>2.88%</td>
</tr>
<tr>
<td>The Prime Rate</td>
<td>4.50%</td>
<td>4.50%</td>
<td>4.50%</td>
</tr>
</tbody>
</table>

Source: ARMinindexes.com
# ARM Indexes

## Current Indexes for Adjustable Rate Mortgages

**Last update: 05/30/2018**

<table>
<thead>
<tr>
<th>Security</th>
<th>Week ending 05/25/18</th>
<th>Month of Apr 18</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Year Treasury Security</td>
<td>2.31%</td>
<td>2.15%</td>
</tr>
<tr>
<td>3 Year Treasury Security</td>
<td>2.68%</td>
<td>2.52%</td>
</tr>
<tr>
<td>5 Year Treasury Security</td>
<td>2.84%</td>
<td>2.70%</td>
</tr>
<tr>
<td>10 Year Treasury Security</td>
<td>3.01%</td>
<td>2.87%</td>
</tr>
<tr>
<td>Monthly Treasury Average (MTA)</td>
<td>Apr 18 1.5567%</td>
<td></td>
</tr>
<tr>
<td>FHFA National Mortgage Contract Rate</td>
<td>Apr 18 4.51%</td>
<td></td>
</tr>
<tr>
<td>11th District Cost of Funds</td>
<td>Mar 18 0.814%</td>
<td></td>
</tr>
<tr>
<td>Prime Rate, as of 06/15/17</td>
<td>4.25%</td>
<td></td>
</tr>
</tbody>
</table>

*Source: ARMindexes.com*

Adjustable Rate Mortgages

http://mortgage-x.com/general/mortgage_indexes.asp

Historical performance of the five most popular ARM indexes. [Obtaining Permission to Reproduce]
The Adjustment Period

Depending on the type of ARM loan, the interest rate and monthly payment will change based on the type.

The period between rate changes is called the adjustment period.

- A 1-Year ARM that adjusts every year
- A 3/3 ARM in which the initial interest rate lasts for three years and then is adjusted again every three years
- A 5/5 ARM in which the initial interest rate lasts for five years and then is adjusted again every five years

*See next slide for Hybrid ARM adjustments*

The Servicer must notify the Borrower regarding the first rate adjustment at least seven months before the new payment at the adjusted interest rate. Every subsequent rate/payment change must be disclosed 60 days prior to the change.

Hybrid ARM

A Hybrid ARM
– This loan is a hybrid of a fixed-rate period and an adjustable-rate period
– The interest rate is fixed for a short-term period, then the rate may adjust annually
– A 3/1 ARM will have a 3-year fixed rate period, after that may adjust annually for the remaining term
– A 3/1, 5/1, 7/1, 10/1
  • The first number indicates how long the fixed interest-rate will be; and
  • The second number indicates how often the rate will adjust after the initial period

QM Definition- (iv) been underwritten using the maximum interest rate that may apply during the first 5 years (and with amortizing monthly payments),
Adjustable-rate mortgages (ARM’s) typically include several kinds of caps that control how your interest rate can adjust.

There are three kinds of caps:

- **Initial adjustment cap**: This cap says how much the interest rate can increase the first time it adjusts, after the fixed-rate period expires. It’s common for this cap to be either two or five percent – meaning that at the first rate change, the new rate can’t be more than two (or five) percentage points higher than the initial rate during the fixed-rate period.

- **Subsequent adjustment cap**: This cap says how much the interest rate can increase in the adjustment periods that follow. This cap is most commonly two percent, meaning that the new rate can’t be more than two percentage points higher than the previous rate.

- **Lifetime adjustment cap**: This cap says how much the interest rate can increase in total, over the life of the loan. This cap is most commonly five percent, meaning that the rate can never be five percentage points higher than the initial rate. However, some lenders may have a higher cap.
ARM Caps

Adjustable-rate mortgages (ARM’s) typically include several kinds of caps that control how your interest rate can adjust. An ARM may have different cap structures.

A 10/1 ARM has a 10-year fixed rate period, after that may adjust annually for the remaining term and different lenders may offer different Cap Options.

As an example, a 10/1 Arm may offer:

– 2/6 Caps
  • The first number indicates the initial interest rate cap
  • The second number indicates the subsequent adjustment cap annually

– 5/2/6 Caps
  • The first number indicates the initial interest rate cap
  • The second number indicates the subsequent adjustment rate cap annually
  • The third number indicates the lifetime adjustment rate cap
Example Of A 10/1 ARM With 2/6 Caps

- Index 1 Year MTA: 1.375%
- Discount: 1.00%
- Margin: 2.75%
- Annual Adjustment Cap: 2.00%
- Lifetime Adjustment Cap: 6.00%

*11th year Index: 2.25%

A. Calculate the Fully Indexed Rate:

Index
+Margin
Fully Indexed Rate

1.375
2.75
4.125%

B. Calculate the Starter/Teaser Rate:

Index
+Margin
-Discount
Starter/Teaser Rate

1.375
2.75
1.00%
3.125%

C. Calculate Maximum 11th Year Rate:

Starter Rate
+Annual Adj. Cap
Max 1st Year Rate

3.125%
2.00%
5.125%

D. Calculate 11th Year FIAR:

(New Current*) Index
+Margin
*New FIAR

2.25%
2.75%
5.00%

*New FIAR is the maximum new adjusted Rate if lower than the Max adjusted capped Rate calculation
Example Of A 10/1 ARM With 2/6 Caps

- Index 1 Year MTA: 1.375%
- Discount: 1.00%
- Margin: 2.75%
- Annual Adjustment Cap: 2.00%
- Lifetime Adjustment Cap: 6.00%
- *11th year Index: 2.25%

C. Calculate Maximum 11th Year Rate:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Starter Rate</td>
<td>3.125%</td>
</tr>
<tr>
<td>+Annual Adj. Cap</td>
<td>2.00%</td>
</tr>
<tr>
<td>Max 1st Year Rate</td>
<td>5.125%</td>
</tr>
</tbody>
</table>

D. Calculate 11th Year FIAR:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>(New Current*) Index</td>
<td>2.25%*</td>
</tr>
<tr>
<td>+Margin</td>
<td>2.75%</td>
</tr>
<tr>
<td>*New FIAR</td>
<td>5.00%</td>
</tr>
</tbody>
</table>

If the Index on year 11 is 2.25 (as used in the example above)
What is the Interest Rate that would be charged to the customer?

*New FIAR is the maximum new adjusted Rate if lower than the Max adjusted capped Rate calculation
** The FIAR is typically rounded to the nearest 1/8 if being using as the interest rate
Example Of A 10/1 ARM With 5/2/6 Caps

Index: .750%  
Discount: 1.00%  
Margin: 2.750%  

Annual Adjustment Cap: 2.000%  
Initial Adjustment Cap: 5.000%  
Lifetime Adjustment Cap: 6.000%  

11th year Index: 2.25%

A. Calculate the Fully Indexed Rate:

\[
\text{Index} + \text{Margin} = \text{Fully Indexed Rate}
\]

\[
1.375 + 2.75 = 4.125\%
\]

B. Calculate the Starter/Teaser Rate:

\[
\text{Index} + \text{Margin} - \text{Discount} = \text{Starter/Teaser Rate}
\]

\[
1.375 + 2.75 - 1.00 = 3.125\%
\]

C. Calculate Maximum 11th Year Rate:

\[
\text{Starter Rate} + \text{Annual Adj. Cap} = \text{Max 1st Year Rate}
\]

\[
3.125 + 5.00 = 8.125\%
\]

D. Calculate 11th Year FIAR:

\[
\text{(New Current*) Index} + \text{Margin} = \text{New FIAR}
\]

\[
2.25\%* + 2.75\% = 5.00\%
\]

*New FIAR is the maximum new adjusted Rate if lower than the Max adjusted capped Rate calculation
**Example Of A 10/1 ARM With 5/2/6 Caps**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th>Annual Adjustment Cap: 2.000%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Index:</td>
<td>.750%</td>
<td></td>
</tr>
<tr>
<td>Discount:</td>
<td>1.00%</td>
<td>Initial Adjustment Cap: 5.000%</td>
</tr>
<tr>
<td>Margin:</td>
<td>2.750%</td>
<td>Lifetime Adjustment Cap: 6.000%</td>
</tr>
</tbody>
</table>

11th year Index: 2.25%

**C. Calculate Maximum 11th Year Rate:**

- Starter Rate: 3.125%
- +Annual Adj. Cap: 5.00%
- Max 1st Year Rate: 8.125%

**D. Calculate 11th Year FIAR:**

- (New Current*) Index: 2.25%*
- +Margin: 2.75%
- *New FIAR: 5.00%

If the Index on year 11 is 2.25 (as used in the example above) What is the Interest Rate that would be charged to the customer?

*New FIAR is the maximum new adjusted Rate if lower than the Max adjusted capped Rate calculation

** The FIAR is typically rounded to the nearest 1/8 if being using as the interest rate
# ARM Loan Estimate (LE)

## Loan Terms

<table>
<thead>
<tr>
<th><strong>Loan Amount</strong></th>
<th>$211,000</th>
<th><strong>Can this amount increase after closing?</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Interest Rate</strong></td>
<td>4%</td>
<td>YES  - Adjusts every 3 years starting in year 6</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CAN AS HIGH AS 12% in year 15</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SEE AIR TABLE ON PAGE 2 FOR DETAILS</td>
</tr>
<tr>
<td><strong>Monthly Principal &amp; Interest</strong></td>
<td>$703.33</td>
<td>YES  - Adjusts every 3 years starting in year 6</td>
</tr>
<tr>
<td></td>
<td></td>
<td>CAN AS HIGH AS $2,068 in year 15</td>
</tr>
<tr>
<td></td>
<td></td>
<td>INCLUDES ONLY INTEREST AND NO PRINCIPAL UNTIL YEAR 6</td>
</tr>
<tr>
<td></td>
<td></td>
<td>SEE AP TABLE ON PAGE 2 FOR DETAILS</td>
</tr>
</tbody>
</table>

## Adjustable Payment (AP) Table

<table>
<thead>
<tr>
<th><strong>Interest Only Payments?</strong></th>
<th>YES for your first 60 payments</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Optional Payments?</strong></td>
<td>NO</td>
</tr>
<tr>
<td><strong>Step Payments?</strong></td>
<td>NO</td>
</tr>
<tr>
<td><strong>Seasonal Payments?</strong></td>
<td>NO</td>
</tr>
<tr>
<td><strong>Monthly Principal and Interest Payments</strong></td>
<td></td>
</tr>
<tr>
<td><strong>First Change/Amount</strong></td>
<td>$1,028 – $1,259 at 61st payment</td>
</tr>
<tr>
<td><strong>Subsequent Changes</strong></td>
<td>Every three years</td>
</tr>
<tr>
<td><strong>Maximum Payment</strong></td>
<td>$2,068 starting at 169th payment</td>
</tr>
</tbody>
</table>

## Adjustable Interest Rate (AIR) Table

<table>
<thead>
<tr>
<th><strong>Index + Margin</strong></th>
<th>MTA + 4%</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initial Interest Rate</strong></td>
<td>4%</td>
</tr>
<tr>
<td><strong>Minimum/Maximum Interest Rate</strong></td>
<td>3.25%/12%</td>
</tr>
<tr>
<td><strong>Change Frequency</strong></td>
<td></td>
</tr>
<tr>
<td><strong>First Change</strong></td>
<td>BEGINNING OF 61ST MONTH</td>
</tr>
<tr>
<td><strong>Subsequent Changes</strong></td>
<td>EVERY 36TH MONTH AFTER FIRST CHANGE</td>
</tr>
<tr>
<td><strong>Limits on Interest Rate Changes</strong></td>
<td></td>
</tr>
<tr>
<td><strong>First Change</strong></td>
<td>2%</td>
</tr>
<tr>
<td><strong>Subsequent Changes</strong></td>
<td>2%</td>
</tr>
</tbody>
</table>

---

Adjustable Rate Mortgages
ARM Disclosure

Adjustable Rate Mortgage Disclosure
(This is neither a contract nor a commitment to lend.)

Lender

Adjustable Rate Mortgage (ARM) Program: C 7/1 YR ARM LBR 5/2/5 NC VT
This disclosure describes the features of the ARM loan you are considering. Information on other ARM programs is available upon request.

How Your Interest Rate and Payment Are Determined

• Your interest rate will be based on an index plus a margin.
• This ARM loan has a discount feature, and your initial interest rate will not be based on the index used for later adjustments. Please ask about our current discount or premium amount.
• This type of ARM loan carries a provision for a change in the Interest Rate and Monthly Payment.
• Your payment will be based on the interest rate, loan balance and loan term.
• The index used to determine your initial interest rate and/or all adjustments is the average of interbank offered rates for one-year U.S. dollar-denominated deposits in the London market (LIBOR).
• Information about the index can be found published daily in the Wall Street Journal.
• Your interest rate will be equal to the index rate plus our margin rounded to the nearest 1/16% less than the index rate.
• Your interest rate will never be less than 1.25% less than the index rate.
• Ask us for our current interest rate and margin.

How Your Interest Rate Can Change

• Your interest rate can change in 34 Months, and every year thereafter.
• Your interest rate cannot increase more than 3 percentage points at the initial adjustment.
• Your interest rate cannot decrease more than 5 percentage points at the initial adjustment.
• Your interest rate cannot increase more than 2 percentage points at each periodic adjustment.
• Your interest rate cannot decrease more than 2 percentage points at each periodic adjustment.
• Your interest rate cannot increase or decrease substantially based on yearly changes in the interest rate.
• Your monthly payment cannot increase or decrease substantially based on yearly changes in the interest rate.
• You will be notified at least 210, but no more than 240, days before the first payment at the adjusted level is due after the initial interest rate adjustment of the loan. This notice will contain information about the adjustment, including the interest rate, payment amount, and loan balance.
• You will be notified at least 60, but no more than 120, days before the first payment at the adjusted level is due after any interest rate adjustment resulting in a corresponding payment change. This notice will contain information about the adjustment, including the interest rate, payment amount, and loan balance.

Additional Features of Your ARM Program

• You may make either all or none of your payments to any amount you choose, but you must pay at least the minimum payment including principal and interest to avoid the imposition of a late charge.
• This ARM Program does not have a Demand Feature.
• This ARM Program does not have a Balloon Payment Feature.
• We hereby acknowledge receipt of this ARM disclosure and a copy of the Consumer Handbook on Adjustable Rate Mortgages on the date indicated below.

Borrower

Sample Sample Date

Genworth
CFPB Disclosures

Your home loan toolkit
A step-by-step guide

Consumer handbook on adjustable-rate mortgages

Agency Guidelines
For Adjustable Rate Mortgages
# Fannie Mae Eligibility Matrix

## Standard Eligibility Requirements - Desktop Underwriter Version 10.2

Excludes: DU Refi Plus, HomeStyle Renovation, Manufactured Housing, and HomeReady

<table>
<thead>
<tr>
<th>Transaction Type</th>
<th>Number of Units</th>
<th>Maximum LTV, CLTV, HCLTV</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Principal Residence</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase</td>
<td>1 Unit</td>
<td>FRM: 97% (1) ARM: 95%</td>
</tr>
<tr>
<td>Limited Cash-Out Refinance</td>
<td>2 Unit</td>
<td>FRM/ARM: 85%</td>
</tr>
<tr>
<td></td>
<td>3-4 Units</td>
<td>FRM/ARM: 75%</td>
</tr>
<tr>
<td>Cash-Out Refinance</td>
<td>1 Unit</td>
<td>FRM/ARM: 80%</td>
</tr>
<tr>
<td></td>
<td>2-4 Units</td>
<td>FRM/ARM: 75%</td>
</tr>
<tr>
<td><strong>Second Homes</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase</td>
<td>1 Unit</td>
<td>FRM/ARM: 90%</td>
</tr>
<tr>
<td>Limited Cash-Out Refinance</td>
<td>1 Unit</td>
<td>FRM/ARM: 75%</td>
</tr>
<tr>
<td><strong>Investment Property</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchase</td>
<td>1 Unit</td>
<td>FRM/ARM: 85%</td>
</tr>
<tr>
<td>Limited Cash-Out Refinance</td>
<td>1-4 Units</td>
<td>FRM/ARM: 75%</td>
</tr>
<tr>
<td>Cash-Out Refinance</td>
<td>1 Unit</td>
<td>FRM/ARM: 75%</td>
</tr>
<tr>
<td></td>
<td>2-4 Units</td>
<td>FRM/ARM: 70%</td>
</tr>
</tbody>
</table>
Fannie Mae ARM’s

Initial Note Rate Limitations

Fannie Mae limits the initial note rate for ARM's with initial interest rate periods of less than five years.

The limitation requires comparison of the initial note rate to the fully indexed rate that is applicable at the time the mortgage is originated.

Mortgage Margin

The mortgage margin is the “spread” that is added to the index value to develop the interest accrual rate for the mortgage. The maximum mortgage margin may be no more than 300 basis points.

When lenders offer a deeply discounted “teaser” rate for the mortgage, the margin is generally not used in determining the initial interest rate, but will be used to determine the interest rate for all future interest rate changes.
Fannie Mae Qualifying Requirements

B3-6-04: Qualifying Payment Requirements (04/15/2014)

This topic contains information on determining the borrower’s monthly PITIA used for qualifying purposes, including:

- Qualifying Payment Amount
- Additional Information About ARM Qualifying for DU Loan Casefiles
- Additional Qualifying Considerations for Specific Products

Qualifying Payment Amount

The calculation of the qualifying payment amount for the subject property will differ based on the transaction type (as shown in the following table).

These policies apply to both manually underwritten loans and DU loan casefiles. In all cases, qualification must consider the borrower’s current obligations and other mortgage-related obligations, i.e., PITIA.

Mortgage loans subject to temporary interest rate buydowns must be qualified without consideration of the bought-down rate, based on the transaction type below.

<table>
<thead>
<tr>
<th>Qualifying Interest Rate Requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Transaction Type</strong></td>
</tr>
<tr>
<td>---------------------------------------</td>
</tr>
<tr>
<td>Fixed-rate mortgages</td>
</tr>
<tr>
<td>ARM with an initial fixed-rate period of five years or less</td>
</tr>
<tr>
<td>ARM with an initial fixed-rate period of greater than five years</td>
</tr>
</tbody>
</table>
Freddie Mac ARM’s

4401.1: Eligible ARMs (03/02/16)

Freddie Mac will purchase rate-capped ARMs that are fully amortizing First Lien Mortgages with an original maturity not exceeding 30 years. For Higher-Priced Mortgage Loan and Higher-Priced Covered Transaction requirements, see the Glossary and Section 4202.5.

Many of the sections of this chapter have charts that set forth specific requirements for eligible ARM products, such as the Index and Lookback Period applicable to each ARM product, the Initial Cap and Periodic Cap of each ARM product and the Uniform Instruments to be used in connection with the origination of each ARM product. Exhibit 175, Available Mortgage Products, provides a consolidated summary of certain information contained in the charts of this chapter regarding eligible ARM products.
Freddie Mac Qualifying Requirements

4401.8: Underwriting requirements for ARMs (11/15/17)

(a) Special ARM qualifications

For 1/1 ARMs, 3/3 ARMs, 5/5 ARMs, 3/1 ARMs, 5/1 ARMs that are less than one year old at the time of delivery, the initial Note Rate cannot be more than three percentage points below the fully-indexed rate. For purposes of this Section 4401.8, the fully-indexed rate is the sum of the Margin plus a value of the applicable Index at any time within 90 days preceding the Note Date, rounded to the nearest one-eighth of 1% (0.125%).

(b) Calculating Borrower ratios for ARMs

For all ARMs, the Borrower must be qualified as follows:

<table>
<thead>
<tr>
<th>ARM Type</th>
<th>Borrower Qualified at</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1 ARM</td>
<td>No less than the greater of the Note Rate plus two percentage points or the fully-indexed rate</td>
</tr>
<tr>
<td>3/1 ARM</td>
<td>For Mortgages with Application Received Dates prior to January 10, 2014, no less than the Note Rate.</td>
</tr>
<tr>
<td>3/3 ARM</td>
<td>For Mortgages with Application Received Dates on or after January 10, 2014, no less than the:</td>
</tr>
<tr>
<td>5/1 ARM</td>
<td>• Note Rate for Mortgages that are not Higher-Projected Covered Transactions (HPCTs) or Higher-Projected Mortgage Loans (HPMLs)</td>
</tr>
<tr>
<td>5/5 ARM</td>
<td>• Greater of the Note Rate or the fully-indexed rate for Mortgages that are HPCTs or HPMLs</td>
</tr>
<tr>
<td>7/1 ARM</td>
<td></td>
</tr>
<tr>
<td>10/1 ARM</td>
<td></td>
</tr>
</tbody>
</table>
ARM Quiz

Index: 0.750%  
Annual Adjustment Cap: 2.000%
Discount: 1.250%  
Initial Adjustment Cap: 5.000%
Margin: 2.750%  
Lifetime Adjustment Cap: 6.000%
6th year Index: 3.000%

1. What is the initial Fully Indexed Accrual Rate (FIAR)?

2. What is the start/teaser rate?

3. What is the Qualifying Rate?

4. What is the FIAR in year 6?

5. Does this amount exceed the cap? If yes, what is the maximum rate allowed?
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Freddie Mac Form 611 Calculator (2015-2016)
Schedule A/B Method (SA/B) Calculator (2015-2016)
Rent Income Calculator (2015-2016)

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