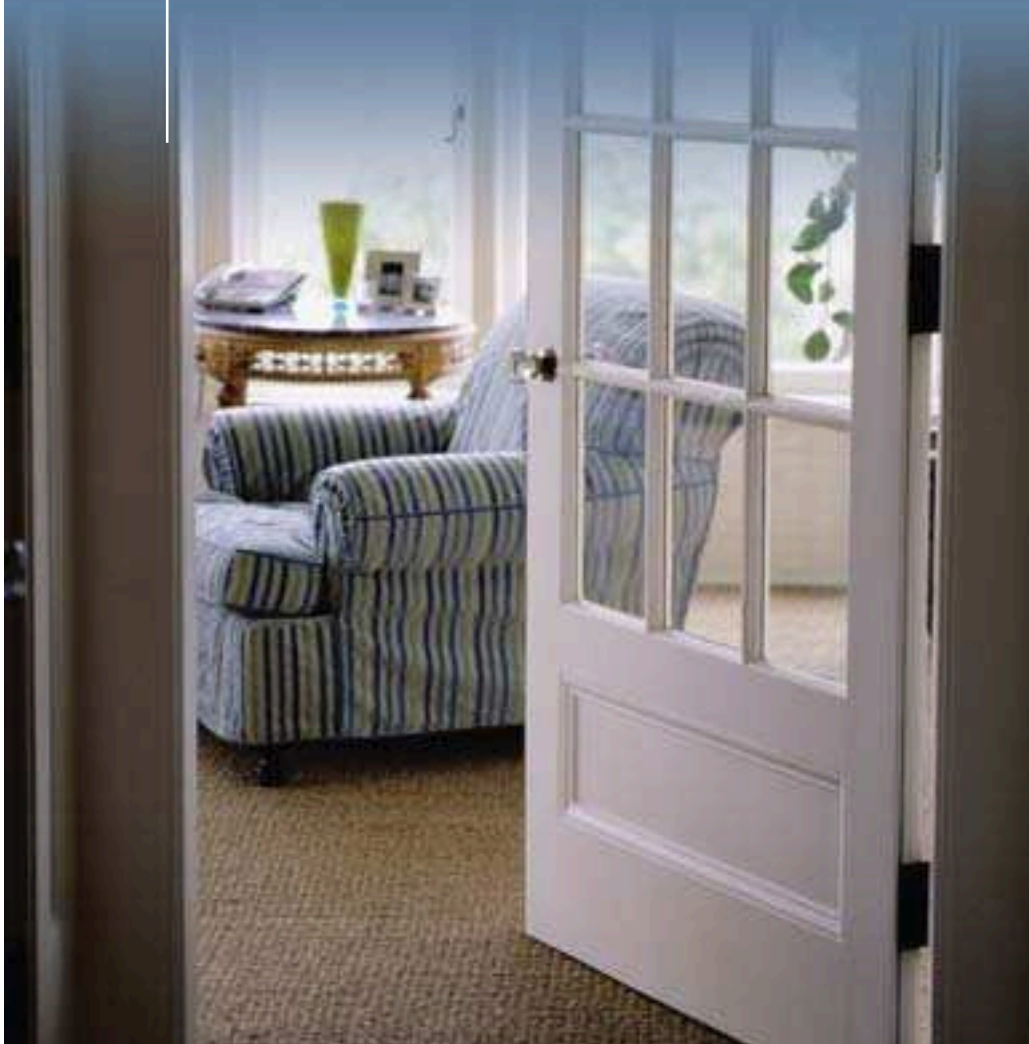


Consumer Handbook

Adjustable Rate Mortgages



The Federal Reserve Board and the Office of Thrift Supervision have prepared this booklet on adjustable rate mortgages (ARMs) in response to a request from the House Committee on Banking, Finance and Urban Affairs and in consultation with many other agencies and trade and consumer groups. It is designed to help consumers understand an important and complex mortgage option available to homebuyers.

We believe a fully informed consumer is in the best position to make a sound economic choice. If you are buying a home and looking for a home loan, this booklet will provide useful basic information about ARMs. It cannot provide all the answers you will need, but we believe it is a good starting point.

Your Lender has included descriptions and disclosures on its various Adjustable Rate Mortgage products beginning on page 20 of this booklet.

People Are Asking. . .

“Some newspaper ads for home loans show surprisingly low rates. Are these loans for real, or is there a catch?”

Some of the ads you see are for adjustable-rate mortgages (ARMs). These loans may have low rates for a short time – maybe only for the first year. After that, the rates may be adjusted on a regular basis. This means that the interest rate and the amount of the monthly payment may go up or down.

“Will I know in advance how much my payment may go up?”

With an adjustable-rate mortgage, your future monthly payment is uncertain. Some types of ARMs put a ceiling on your payment increase or interest-rate increase from one period to the next. Virtually all must put a ceiling on rate increases over the life of the loan.

“Is an ARM the right type of loan for me?”

That depends on your financial situation and the terms of the ARM. ARMs carry risks in periods of rising interest rates, but they can be cheaper over a longer term if interest rates decline. You will be able to answer the question better once you understand more about ARMs. This booklet should help.

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Mortgages have changed, and so have the questions that consumers need to ask and have answered.

Shopping for a mortgage used to be a relatively simple process. Most home mortgage loans had interest rates that did not change over the life of the loan. Choosing among these fixed-rate mortgage loans meant comparing interest rates, monthly payments, fees, prepayment penalties, and due-on-sale clauses.

Today, many loans have interest rates (and monthly payments) that can change from time to time. To compare one ARM with another or with a fixed-rate mortgage, you need to know about indexes, margins, discounts, caps, negative amortization, and convertibility. You need to consider the maximum amount your monthly payment could increase. Most important, you need to compare what might happen to your mortgage costs with your future ability to pay.

This booklet explains how ARMs work and some of the risks and advantages to borrowers that ARMs introduce. It discusses features that can help reduce the risks and gives some pointers about advertising and other ways you can get information from lenders. Important ARM terms are defined in a glossary on page 15. And a checklist on page 18 should help you ask lenders the right questions and figure out whether an ARM is right for you. Asking lenders to fill out the checklist is a good way to get the information you need to compare mortgages.

What Is An ARM?

With a fixed-rate mortgage, the interest rate stays the same during the life of the loan. But with an ARM, the interest rate changes periodically, usually in relation to an index, and payments may go up or down accordingly.

Lenders generally charge lower initial interest rates for ARMs than for fixed-rate mortgages. This makes the ARM easier on your pocketbook at first than a fixed-rate mortgage for the same amount. It also means that you might qualify for a larger loan because lenders sometimes make the decision about whether to extend a loan on the basis of your current income and the first year's payments. Moreover, your ARM could be less expensive over a long period than a fixed-rate mortgage – for example, if interest rates remain steady or move lower.

Against these advantages, you have to weigh the risk that an increase in interest rates would lead to higher monthly payments in the future. It's a trade-off – you get a lower rate with an ARM in exchange for assuming more risk.

Here are some questions you need to consider:

- Is my income likely to rise enough to cover higher mortgage payments if interest rates go up?
- Will I be taking on other sizable debts, such as a loan for a car or school tuition, in the near future?
- How long do I plan to own this home? (If you plan to sell soon, rising interest rates may not pose the problem they do if you plan to own the house for a long time.)
- Can my payments increase even if interest rates generally do not increase?

How ARMs Work: The Basic Features

The Adjustment Period

With most ARMs, the interest rate and monthly payment change every year, every three years or every five years. However, some ARMs have more frequent interest and payment changes. The period between one rate change and the next is called the “adjustment period”. A loan with an adjustment period of one year is called a one-year ARM, and the interest rate can change once every year.

The Index

Most lenders tie ARM interest-rate changes to changes in an “index rate.” These indexes usually go up and down with the general movement of interest rates. If the index rate moves up, so does your mortgage rate in most circumstances, and you will probably have to make higher monthly payments. On the other hand, if the index rate goes down your monthly payment may go down.

Lenders base ARM rates on a variety of indexes. Among the most common are the rates on one-, three-, or five-year Treasury securities. Another common index is the national or regional average cost of funds to savings and loan associations. A few lenders use their own cost of funds as an index, which gives them more control than using other indexes. You should ask what index will be used and how often it changes. Also ask how it has fluctuated in the past and where it is published.

The Margin

To determine the interest rate on an ARM, lenders add to the index rate a few percentage points called the “margin.” The amount of the margin may differ from one lender to another, but it is usually constant over the life of the loan.

Index rate + margin = ARM interest rate

Let's say, for example, that you are comparing ARMs offered by two different lenders. Both ARMs are for 30 years and have a loan amount of \$65,000. (All the examples used in this booklet are based on this amount for a 30-year term. Note that the payment amounts shown here do not include taxes, insurance or similar items.)

Both lenders use the rate on one-year Treasury securities as the index. But the first lender uses a 2% margin, and the second lender uses a 3% margin. Here is how that difference in margin would affect your initial monthly payment.

Home sale price:	\$85,000
Less down payment:	<u>-20,000</u>
Mortgage amount:	\$65,000
Mortgage term:	30 years

First Lender

One-year index 8%
Margin = 2%
ARM interest rate = 10%
Monthly payment @ 10% = \$570.42

Second Lender

One-year index = 8%
Margin = 3%
ARM interest rate = 11%
Monthly payment @ 11% = \$619.01

In comparing ARMs, look at both the index and margin for each program. Some indexes have higher average values, but they are usually used with lower margins. Be sure to discuss the margin with your lender.

Consumer Cautions

Discounts

Some lenders offer initial ARM rates that are lower than their “standard” ARM rates (that is, lower than the sum of the index and the margin.) Such rates, called discounted rates, are often combined with large initial loan fees (“points”) and with much higher interest rates after the discount expires.

Very large discounts are often arranged by the seller. The seller pays an amount to the lender so the lender can give you a lower rate and lower payments early in the mortgage term. This arrangement is referred to as a “seller buydown.” The seller may increase the sales price of the home to cover the cost of the buydown.

A lender may use a low initial rate to decide whether to approve your loan, based on your ability to afford it. You should be careful to consider whether you will be able to afford payments in later years, when the discount expires and the rate is adjusted.

Here is how a discount might work. Let’s assume that the Lender’s “standard” one-year ARM rate (index rate plus margin) is currently at 10%. But your lender is offering an 8% rate for the first year. With the 8% rate, your first year monthly payment would be \$476.95.

But don’t forget that with a discounted ARM, your initial payment will probably remain at \$476.95 for only 12 months, and that any savings during the discount period may be made up during the life of the mortgage or may be included in the price of the house. In fact, if you buy a home using this kind of loan, you run the risk of. . .

Payment Shock

Payment shock may occur if your mortgage payment rises very sharply at the first adjustment. Let’s see what would happen in the second year if the rate on your discounted 8% ARM were to raise to the 10% “standard” rate.

ARM Interest Rate	Monthly Payment
1st year (w/discount) @ 8%	\$476.95
2nd year @ 10%	\$568.82

As the example shows, even if the index rate were to stay the same, your monthly payment would go up from \$476.95 to \$568.82 in the second year.

Suppose that the index rate increases 2% in one year and the ARM rate rises to 12%.

ARM Interest Rate	Monthly Payment
1st year (w/discount) @ 8%	\$476.95
2nd year @ 12%	\$665.43

That's an increase of almost \$200 in your monthly payment. You can see what might happen if you choose an ARM because of a low initial rate. You can protect yourself from large increases by looking for a mortgage with features, described next, that may reduce this risk.

How Can I Reduce My Risk?

Besides offering an overall rate ceiling, most ARMs also have “caps” that protect borrowers from extreme increases in monthly payments. Others allow borrowers to convert an ARM to a fixed-rate mortgage. While they may offer real benefits, these ARMs may also cost more, or add special features, such as negative amortization.

Interest-Rate Caps

An interest-rate cap places a limit on the amount your interest rate can increase. Interest caps come in two versions:

- Periodic caps, which limit the interest-rate increase from one adjustment period to the next; and
- Overall caps, which limit the interest-rate increase over the life of the loan.

By law, virtually all ARMs must have an overall cap. Many have a periodic cap.

Let's suppose you have an ARM with a periodic interest rate cap of 2%. At the first adjustment, the index rate goes up 3%. The example shows what happens.

ARM Interest Rate	Monthly Payment
1st year @ 10%	\$570.42
2nd year @ 13% (without cap)	\$717.12
2nd year @ 12% (with cap)	\$667.30
Difference in 2nd year between payment with cap and payment without = \$49.82	

A drop in interest rates does not always lead to a drop in monthly payments. In fact, with some ARMs that have interest rate caps, your payment amount may increase even though the index rate has stayed the same or declined. This may happen when an interest rate cap has been holding your interest rate down below the sum of the index plus margin. If a rate cap holds down your interest rate, increases to the index that were not imposed because of the cap may carry over to future rate adjustments.

With some ARMs, payments may increase even if the index rate stays the same or declines.

The following example shows how carryovers work. The index increased 3% during the first year. Because this ARM limits rate increases to 2% at any one time, the rate is adjusted by only 2%, to 12% for the second year. However, the remaining 1% increase in the index carries over to the next time the lender can adjust rates. So when the lender adjusts the interest rate for the third year, the rate increases 1%, to 13%, even though there is no change in the index the second year.

ARM Interest Rate	Monthly Payment
1st year @ 10%	\$570.42
If index rises 3%...	
2nd year @ 12% (with 2% rate cap)	\$667.30
If the index stays the same for the 3rd year @ 13%	\$716.56
Even though index stays the same in 3rd year, payment goes up \$49.26	

In general, the rate on your loan can go up at any scheduled adjustment date when the lender's standard ARM rate (the index plus the margin) is higher than the rate you are paying before that adjustment.

The next example shows how a 5% overall rate cap would affect your loan.

ARM Interest Rate	Monthly Payment
1st year @ 10%	\$570.42
10th year @ 15% (with cap)	\$813.00

Let's say that the index rate increases 1% in each of the next nine years. With a 5% overall cap, your payment would never exceed \$813.00 — compared to the \$1,008.64 that it would have reached in the tenth year based on a 19% interest rate.

Payment Caps

Some ARMs include payment caps, which limit your monthly payment increase at the time of each adjustment, usually to a percentage of the previous payment. In other words, with a 7 1/2% payment cap, a payment of \$100 could increase to no more than \$107.50 in the first adjustment period, and to no more than \$115.56 in the second.

Let's assume that your rate changes in the first year by 2 percentage points, but your payments can increase by no more than 7 1/2% in any one year. Here's what your payments would look like:

ARM Interest Rate	Monthly Payment
1st year @ 10%	\$570.42
2nd year @ 12% (without payment cap)	\$667.30
2nd year @ 12% (with 7 1/2 % payment cap)	\$613.20
Difference in monthly payment =	\$ 54.10

Many ARMs with payment caps do not have periodic interest-rate caps.

Negative Amortization

If your ARM includes a payment cap, be sure to find out about "negative amortization." Negative amortization means that the mortgage balance increases. It occurs whenever your monthly mortgage payments are not large enough to pay all of the interest due on your mortgage.

Because payment caps limit only the amount of payment increases, and not interest-rate increases, payments sometimes do not cover all of the interest due on your loan. This means that the interest shortage in your payment is automatically added to your debt, and interest may be charged on that amount. You might therefore owe the lender more later in the loan term than you did at the start. However, an increase in the value of your home may make up for the increase in what you owe.

The next illustration uses the figures from the preceding example to show how negative amortization works during one year. Your first 12 payments of \$570.42, based on a 10% interest rate, paid the balance down to \$64,638.72 at the end of the first year. The rate goes up to 12% in the second year. But because of the 7 1/2% payment cap, your payments are not high enough to cover all the interest. The interest shortage is added to your debt (with interest on it), which produces negative amortization of \$420.90 during the second year.

Beginning Loan amount = \$65,000

Loan amount at end of 1st year = \$64,638.72

Negative amortization during 2nd year = \$420.90

Loan amount at end of 2nd year = \$65,059.62
(\$64,638.72 + \$420.90)

(If you sold your house at this point, you would owe almost \$60 more than the amount you originally borrowed.)

To sum up, the payment cap limits increases in your monthly payment by deferring some of the increase in interest. Eventually, you will have to repay the higher remaining loan balance at the ARM rate then in effect. When this happens, there may be a substantial increase in your monthly payment.

Some mortgages include a cap on negative amortization. The cap typically limits the total amount you can owe to 125% of the original loan amount. When that point is reached, monthly payments may be set to fully repay the loan over the remaining term, and your payment cap may not apply. You may limit negative amortization by voluntarily increasing your monthly payment.

Be sure to discuss negative amortization with the lender to understand how it will apply to your loan.

Prepayment and Conversion

If you get an ARM and your financial circumstances change, you may decide that you don't want to risk any further changes in the interest rate and payment amount. When you are considering an ARM, ask for information about prepayment and conversion.

Prepayment. Some agreements may require you to pay special fees or penalties if you pay off the ARM early. Many ARMs allow you to pay the loan in full or in part without penalty whenever the rate is adjusted. Prepayment details are sometimes negotiable. If so, you may want to negotiate for no penalty, or for as low a penalty as possible.

Conversion. Your agreement with the lender may include a clause that lets you convert the ARM to a fixed-rate mortgage at designated times. When you convert, the new rate is generally set at the current market rate for fixed-rate mortgages.

The interest rate or up-front fees may be somewhat higher for a convertible ARM. Also, a convertible ARM may require a special fee at the time of conversion.

Where To Get Information

Before you actually apply for a loan and pay a fee, ask for all the information the lender has on the loan you are considering. It is important that you understand index rates, margins, caps, and other ARM features such as negative amortization. You can get helpful information from advertisements and disclosures, which are subject to certain federal standards.

Advertising

Your first information about mortgages probably will come from newspaper advertisements placed by builders, real estate brokers, and lenders. Although this information can be helpful, keep in mind that the ads are designed to make the mortgage look as attractive as possible. These ads may play up low initial interest rates and monthly payments, without emphasizing that those rates and payments later could increase substantially. So get all the facts.

A federal law, the Truth in Lending Act, requires mortgage advertisers, once they begin advertising specific terms, to give further information on the loan. For example, if they want to show the interest rate or payment amount on the loan, they must also tell you the annual percentage rate (APR) and whether that rate may go up. The APR, the cost of your credit as a yearly rate, reflects more than just a low initial rate. It takes into account interest, points paid on the loan, any loan origination fee, and any mortgage insurance premiums you may have to pay.

**Ads may play up low initial rates.
Get all the facts.**

Disclosures From Lenders

Federal law requires the lender to give you information about ARMs, in most cases before you apply for a loan. The lender also is required to give you information when you apply for a mortgage. You should get a written summary of important terms and costs of the loan. Some of these are the finance charge, the APR, and the payment terms.

**Read information from lenders — and ask questions —
before committing yourself.**

Selecting a mortgage may be the most important financial decision you will make, and you are entitled to all the information you need to make the right decision. Don't hesitate to ask questions about ARM features when you talk to lenders, real estate brokers, sellers, and your attorney, and keep asking until you get clear and complete answers. The checklist on page 18 of this pamphlet is intended to help you compare terms on different loans.

Glossary

Adjustable-Rate Mortgage (ARM)

A mortgage where the interest rate is not fixed, but changes during the life of the loan in line with movements in an index rate. You may also see ARMs referred to as AMLs (adjustable mortgage loans) or VRMs (variable-rate mortgages).

Annual Percentage Rate (APR)

A measure of the cost of credit, expressed as a yearly rate. It includes interest as well as other charges. Because all lenders follow the same rules when calculating the APR, it provides consumers with a good basis for comparing the cost of loans, including mortgages.

Assumability

When a home is sold, the seller may be able to transfer the mortgage to the new buyer. This means the mortgage is assumable. Lenders generally require a credit review of the new borrower and may charge a fee for the assumption. Some mortgages contain a due-on-sale clause, which means that the mortgage may not be transferable to a new buyer. Instead, the lender may make you pay the entire balance that is due when you sell the home. Assumability can help you attract buyers if you sell your home.

Buydown

With a buydown, the seller pays an amount to the lender so that the lender can give you a lower rate and lower payments, usually for an early period in an ARM. The seller may increase the sales price to cover the cost of the buydown. Buydowns can occur in all types of mortgages, not just ARMs.

Cap

A limit on how much the interest rate or the monthly payment may change, either at each adjustment or during the life of the mortgage. Payment caps don't limit the amount of interest the lender is earning, so they may cause *negative amortization*.

Conversion Clause

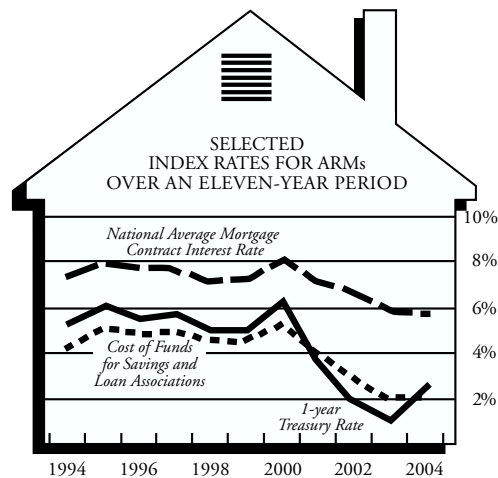
A provision in some ARMs that allows you to change the ARM to a fixed-rate loan at some point during the term. Conversion is usually allowed at the end of the first adjustment period. At the time of the conversion, the new fixed rate is generally set at one of the rates then prevailing for fixed-rate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

Discount

In an ARM with an initial rate discount, the lender gives up a number of percentage points in interest to give you a lower rate and lower payments for part of the mortgage term (usually for one year or less). After the discount period, the ARM rate will probably go up depending on the index rate.

Index

The index is the measure of interest rate changes that the lender uses to decide how much the interest rate on an ARM will change over time. No one can be sure when an index rate will go up or down. To help you get an idea of how to compare different indexes, the following chart shows a few common indexes over an eleven-year period (1994-2004). As you can see, some index rates tend to be higher than others, and some more volatile. (But if a lender bases interest rate adjustments on the average value of an index over time, your interest rate would not be as volatile.) You should ask your lender how the index for any ARM you are considering has changed in recent years, and where the index is reported.



Margin

The number of percentage points the lender adds to the index rate to calculate the ARM interest rate at each adjustment.

Negative Amortization

Amortization means that monthly payments are large enough to pay the interest and reduce the principal on your mortgage. Negative amortization occurs when the monthly payments do not cover all of the interest cost. The interest cost that isn't covered is added to the unpaid principal balance. This means that even after making many payments, you could owe more than you did at the beginning of the loan. Negative amortization can occur when an ARM has a payment cap that results in monthly payments not high enough to cover the interest due.

Points

One point is equal to 1 percent of the principal amount of your mortgage. For example, if the mortgage is for \$65,000, one point equals \$650. Lenders frequently charge points in both fixed-rate and adjustable-rate mortgages in order to increase the yield on the mortgage and to cover loan closing costs. These points usually are collected at closing and may be paid by the borrower or the home seller, or may be split between them.

Mortgage Checklist

Ask your lender to help fill out this checklist.

Mortgage amount

Basic Features for Comparison

Fixed-rate annual percentage rate (The cost of your credit as a yearly rate including both interest and other charges)

ARM annual percentage rate

 Adjustment period

 Index used and current rate

 Margin

 Initial payment without discount

 Initial payment with discount (if any)

 How long will discount last?

 Interest rate caps: periodic

 overall

 Payment caps

 Negative amortization

 Convertibility or prepayment privilege

 Initial fees and charges

Monthly Payment Amounts

What will my monthly payment be after 12 months if the index rate —
 stays the same?

 goes up 2%?

 goes down 2%?

What will my monthly payments be after 3 years if the index rate —
 stays the same?

 goes up 2% per year?

 goes down 2% per year?

Take into account any caps on your mortgage and remember it may run 30 years.

Your Lender's ARM Disclosure and Description of Programs

This disclosure describes the features of the adjustable-rate mortgage (ARM) programs your lender offers. This disclosure is not a commitment by the lender to make you a loan on any of the terms described in this disclosure. It is intended solely to provide you with a general description of your lender's loan programs. If you eventually obtain a loan from the lender, the loan note, security instrument and related documents ("Loan Documents") will establish your legal rights and obligations. Information on any other ARM programs we may have is available on request.

I. ARM Program

How Your Interest Rate and Payments are Determined

Your interest rate will be based on an index plus a margin. Your payment will be based on the interest rate, loan balance, and loan term.

The initial interest rate may be a discount rate or premium rate and may not be based on the index used to make later adjustments. A premium interest rate is one that is greater than the interest rate calculated by adding the index and the margin. A discount interest rate is one that is less than the interest rate calculated by adding the index and the margin. Ask us for the amount of any current interest rate discounts or premiums. After the initial period, your interest rate will equal the current index rate plus the margin rounded to the nearest 1/8 of one percentage point (0.125%), unless an Adjustment Cap or the Lifetime Cap limits the amount of change in the interest rate. Ask us for our current interest rate and margin.

The index will depend on which ARM program you select. We offer ARM programs with the following indexes:

United States Treasury Securities

The index is the weekly average yield on United States Treasury Securities adjusted to a constant maturity of one year. Information about this index is published by the Federal Reserve Board in publication H.15 (519).

You may request to be placed on the mailing list to receive copies of this weekly publication by writing: Publications Fulfillment, Mail Stop 127, Board of Governors, Federal Reserve System, Washington, D.C. 20551. If for any reason this index is not available, the Lender will use a new index based on comparable information.

London Interbank Offered Rates (LIBOR)

The index is the average of interbank offered rates for one-year or six-month U.S. dollar-denominated deposits in the London market (“LIBOR”), as published in The Wall Street Journal. If for any reason this index is not available, the Lender will use a new index based on comparable information.

How Your Interest Rate Can Change

Your interest rate can change every month to thirty six months after the first interest rate change date (“First Change Date”). The First Change Date and Subsequent Change Dates will depend on which ARM program you select as set forth in the following chart:

Program	First Change Date from the 1st payment date	Subsequent Change Date after the first change date
Conventional 10-1	119 months	Every 12 months
FHA 10-1	120-126 months	Every 12 months
Conventional 7-1	83 months	Every 12 months
FHA 7-1	84-90 months	Every 12 months
Conventional 5-1	59 months	Every 12 months
FHA 5-1	60-66 months	Every 12 months
Conventional 3-1	35 months	Every 12 months
FHA/VA 3-1	36-42 months	Every 12 months
Conventional 1-1	11 months	Every 12 months
FHA 1-1	12-18 months	Every 12 months
Conventional 10-6	119 months	Every six months
Conventional 7-6	83 months	Every six months
Conventional 5-6	59 months	Every six months
Conventional 3-6	35 months	Every six months
Conventional 2-6	23 months	Every six months
Conventional 6 Month	5 months	Every six months
Conventional 1 Month	1 month	Every month

At the First Change Date, your interest rate cannot increase or decrease more than the First Adjustment Cap. No interest rate change after the First Change Date will be more than the Subsequent Adjustment Cap. Your First Adjustment Cap will be set at an amount between 1 and 5 percentage points, depending on the ARM program. Your Subsequent Adjustment Cap will be set at an amount between 1 and 2 percentage points for each adjustment, depending on the ARM program. There is no limitation on the total amount by which your interest rate can decrease over the life of your loan except that your interest rate can never be lower

than the margin, regardless of how low the index may drop. (For FHA and VA ARM loans, the First Adjustment Cap, Subsequent Adjustment Cap, and Lifetime Cap apply to both increases and decreases.)

Regardless of the current value of the index plus margin, your interest rate can never exceed the Lifetime Cap which will be established when you “lock-in” or price protect with your lender the initial interest rate and discount points applicable to your loan. Your Lifetime Cap will be set at 5 or 6 percentage points above your initial rate, depending on the ARM program. Ask for our current First and Subsequent Adjustment Caps and Lifetime Cap information.

How Your Monthly Payment Can Change

Your monthly payment can increase or decrease substantially based on the annual changes in the interest rate. The amount of your new payments will be due starting on the first monthly payment date after the Change Date until the amount of your monthly payment changes again.

The following examples demonstrate how your monthly payment can change.

A. ARM Programs with Indexes Based on U.S. Treasury Securities

On a \$10,000 loan with the terms and the initial interest rates shown below (minus a discount or plus a premium recently used for the program, which discount or premium is set forth below), the maximum amount that the interest rate can rise under the program is shown below. The monthly payment can increase from the initial payment shown below to the maximum payment shown in the year indicated.

Program	Amortization (years)	Index Value (%)	Margin (%) ⁽²⁾	Discount ^(d) Premium ^(p) (%) ⁽³⁾	Initial Rate (%) ⁽⁴⁾	Initial Paym't	Adjustment Caps ⁽⁵⁾ (%)	Max. Rate ⁽⁶⁾ (%)	Max. Payment	Yr. Of Max. Payment
10-1	30	4.720 ⁽¹⁾	2.75	1.250 ^(d)	6.250	61.57	5/ 2/ 5	11.250	88.39	11
10-1	20	4.720 ⁽¹⁾	2.75	1.250 ^(d)	6.250	73.09	5/ 2/ 5	11.250	90.60	11
7-1	30	4.720 ⁽¹⁾	2.75	1.375 ^(d)	6.125	60.76	5/ 2/ 5	11.125	90.36	8
7-1	20	4.720 ⁽¹⁾	2.75	1.375 ^(d)	6.125	72.37	5/ 2/ 5	11.125	94.42	8
5-1	30	4.720 ⁽¹⁾	2.75	1.375 ^(d)	6.125	60.76	5/ 2/ 5	11.125	92.19	6
5-1	20	4.720 ⁽¹⁾	2.75	1.375 ^(d)	6.125	72.37	5/ 2/ 5	11.125	97.36	6
3-1	30	4.720 ⁽¹⁾	2.75	1.375 ^(d)	6.125	60.76	2/ 2/ 6	12.125	100.25	6
3-1	20	4.720 ⁽¹⁾	2.75	1.375 ^(d)	6.125	72.37	2/ 2/ 6	12.125	104.68	6
1-1	30	4.720 ⁽¹⁾	2.75	1.625 ^(d)	5.875	59.15	2/ 2/ 6	11.875	100.25	4
1-1	20	4.720 ⁽¹⁾	2.00	0.875 ^(d)	5.875	70.92	2/ 2/ 6	11.875	106.26	4
FHA 10-1	30	4.720 ⁽¹⁾	2.25	0.375 ^(d)	6.625	64.03	2/ 2/ 6	12.625	96.24 ⁽⁷⁾	13
FHA 7-1	30	4.720 ⁽¹⁾	2.25	0.250 ^(d)	6.750	64.86	2/ 2/ 6	12.750	101.01 ⁽⁷⁾	10

FHA 5-1	30	4.720 ⁽¹⁾	2.25	0.375 ^(d)	6.625	64.03	1/ 1/ 5	11.625	94.56 ⁽⁷⁾	10
FHA 3-1	30	4.720 ⁽¹⁾	2.25	1.375 ^(d)	5.625	57.57	1/ 1/ 5	10.625	88.48 ⁽⁷⁾	8
FHA 1-1	30	4.720 ⁽¹⁾	2.25	1.375 ^(d)	5.625	57.57	1/ 1/ 5	10.625	90.23 ⁽⁷⁾	6
VA 3-1	30	4.720 ⁽¹⁾	2.25	1.375 ^(d)	5.625	57.57	1/ 1/ 5	10.625	88.48 ⁽⁷⁾	8

- (1) One year Treasury constant maturity for the week ending 2/17/2006 (Fed Pub H.15, released 2/21/2006).
- (2) This is a margin we have used recently for this program; your margin may be different.
- (3) This is the amount of a discount (d) or a premium (p) used recently for this program; your initial rate may be discounted or priced at a premium by a different amount.
- (4) Index Value plus Margin less Discount or plus Premium, rounded to the nearest one eighth of one percent.
- (5) First Adjustment Cap/Subsequent Adjustment Cap/Lifetime Cap.
- (6) Initial Rate plus Lifetime Cap.
- (7) See the table below for the payment schedule for Government ARM Products.

Payment Schedule for Government ARMs, assuming maximum rate increases on a \$10,000 loan. (Initial and maximum interest rates are shown in the preceding table.)

Program	Initial Payment	1st Increase	2nd Increase	3rd Increase	4th Increase	5th Increase
For FHA 10-1 ARM	64.03 for ten years	74.47 in year 11	85.24 in year 12	96.24 in year 13	na	na
For FHA 7-1 ARM	64.86 for seven years	76.50 in year 8	88.59 in year 9	101.01 in year 10	na	na
For FHA 5-1 ARM	64.03 for five years	70.04 in year 6	76.12 in year 7	82.25 in year 8	88.40 in year 9	94.56 in year 10
For FHA 3-1 ARM	57.57 for three years	63.58 in year 4	69.71 in year 5	75.91 in year 6	82.18 in year 7	88.48 in year 8
For VA 3-1 ARM	57.57 for three years	63.58 in year 4	69.71 in year 5	75.91 in year 6	82.18 in year 7	88.48 in year 8
For FHA 1-1 ARM	57.57 for one year	63.89 in year 2	70.34 in year 3	76.90 in year 4	83.54 in year 5	90.23 in year 6

You will be notified in writing at least 25 days, but not more than 120 days, before the due date of a payment at a new level. This notice will contain information about your interest rates, payment amount, and loan balance.

To see what your payment would have been for any program during any period, divide your mortgage amount by \$10,000; then multiply the monthly payment by that amount. (For example, the initial monthly payment on a conventional 5-1 ARM loan for a mortgage amount of \$60,000 with a 30-year term would be: $\$60,000/\$10,000 = 6$; $6 \times \$60.76 = \364.56 . The initial monthly payment for the same loan with a 20 year term would be: $\$60,000/\$10,000 = 6$; $6 \times \$72.37 = \434.22).

B. ARM Programs with Indexes Based on London Interbank Offered Rates (LIBOR)

On a \$10,000 loan with the terms and the initial interest rates shown below (minus a discount or plus a premium recently used for the program, which discount or premium is set forth below), the maximum amount that the interest rate can rise under the program is shown below. The monthly payment can increase from the initial payment shown below to the maximum payment shown in the year indicated.

Program	Amortization (years)	Index Value (%)	Margin (%) ⁽⁴⁾	Discount ^(d) Premium ^(p) (%) ⁽⁵⁾	Initial Rate (%) ⁽⁶⁾	Initial Paym't	Adjustment Caps ⁽⁷⁾ (%)	Max. Rate ⁽⁸⁾ (%)	Max. Payment	Yr. Of Max. Payment
10-1	30	5.15 ⁽¹⁾	2.250	1.000 ^(d)	6.500	63.21	5/ 2/ 5	11.500	90.41	11
7-1	30	5.15 ⁽¹⁾	2.250	1.000 ^(d)	6.375	62.39	5/ 2/ 5	11.380	92.36	8
5-1	30	5.15 ⁽¹⁾	2.250	1.250 ^(d)	6.125	60.76	5/ 2/ 5	11.130	92.19	6
5-1	40	5.15 ⁽¹⁾	2.250	1.125 ^(d)	6.25	56.77	5/ 2/ 5	11.250	92.50	6
5-1	40 ⁽²⁾	5.15 ⁽¹⁾	2.250	1.125 ^(d)	6.250	56.77	5/ 2/ 5	11.250	92.50	6
3-1	30	5.15 ⁽¹⁾	2.250	1.250 ^(d)	6.125	60.76	2/ 2/ 6	12.130	100.25	6
1-1	30	5.15 ⁽¹⁾	2.250	1.250 ^(d)	6.125	60.76	2/ 2/ 6	12.130	102.21	4
10-6	30	4.99 ⁽³⁾	2.250	0.750 ^(d)	6.500	63.21	5/ 1/ 5	11.500	90.41	11
7-6	30	4.99 ⁽³⁾	2.250	0.875 ^(d)	6.375	62.39	5/ 1/ 5	11.380	92.36	8
5-6	30	4.99 ⁽³⁾	2.250	0.875 ^(d)	6.375	62.39	5/ 1/ 5	11.380	94.16	6
3-6	30	4.99 ⁽³⁾	2.250	0.875 ^(d)	6.375	62.39	3/ 1/ 6	12.380	102.07	6
2-6	30	4.99 ⁽³⁾	2.250	1.375 ^(d)	5.875	59.15	3/ 1/ 6	11.880	98.98	5
6-month	30	4.99 ⁽³⁾	2.750	1.250 ^(d)	6.500	63.21	1/ 1/ 6	12.500	105.17	4

- (1) London Interbank Offered Rates - one year, 2/28/2006, Wall Street Journal, Money Rates - 3/1/2006.
- (2) Your periodic payments will not fully amortize your loan and you will be required to make a single payment of the periodic payment plus the remaining unpaid balance at the end of the loan term.
- (3) London Interbank Offered Rates - six months, 2/28/2006, Wall Street Journal, Money Rates - 3/1/2006.
- (4) This is the margin we have used recently for this program; your margin may be different.
- (5) This is the amount of a discount (d) or a premium (p) used recently for this program; your initial rate may be discounted or priced at a premium by a different amount.
- (6) Index Value plus Margin less Discount or plus Premium, rounded to the nearest one eighth of one percent.
- (7) First Adjustment Cap/Subsequent Adjustment Cap/Lifetime Cap.
- (8) Initial Rate plus Lifetime Cap.

You will be notified in writing at least 25 days, but not more than 120 days, before the due date of a payment at a new level. This notice will contain information about your interest rates, payment amount, and loan balance.

To see what your payment would have been for any program during any period, divide your mortgage amount by \$10,000; then multiply the monthly payment by that amount. (For example, the initial monthly payment on a 3-1 LIBOR ARM loan for a mortgage amount of \$60,000 with a 30-year term would be: $\$60,000/\$10,000 = 6$; $6 \times \$60.76 = \434.22 .)

II. Additional Information Concerning Program Features

A. Buydown Option

As a separate feature of our loan programs, we may offer you, in connection with your ARM loan, a buydown option. If you choose to take advantage of the buydown option, you or a third party, such as a seller or builder, may agree to “buydown” your loan payments for a period of years. This means that someone pays a lump sum at closing which we agree to apply as a “subsidy” towards the full monthly payment due under your note for a specified period of time. This lowers your actual out-of-pocket monthly payment during that period of time. A buydown is simply an alternative repayment method for the first few years of your loan.

The following example shows how your monthly payment can change if you have a buydown. For example, a 2-1 buydown over two years, on a \$10,000, 30-year 3-1 ARM, using the rate shown for the 3-1 ARM Program Example, using the U.S. Treasury-based index, would work this way:

Payment Number	Interest Rate	Bought down Rate (off initial)	Bought down Payment (off initial)	Monthly Subsidy Amount	Principal & Interest Payment (P&I)	Borrower Payment (P&I Pmt less Subsidy)
1	6.125	4.125	48.46	12.31	60.77	48.46
13	6.125	5.125	54.45	6.32	60.77	54.45
25	6.125	6.125	60.77	0.00	60.77	60.77

Your monthly payments in year one would have \$12.31 subtracted as the “bought down payment subsidy” and your monthly payments in year two would have \$6.32 subtracted. At the end of the buydown period, you are obligated to make payments based on the interest rate contained in the Loan Documents.

Remember that the terms of the ARM programs described in this disclosure have been described without reference to the buydown option.

B. Interest-Only

How Your Monthly Payment Can Change

Your monthly payment can increase or decrease substantially based on the annual changes in the interest rate. No payments of principal are due during the “Interest-Only Period.” For example, on a \$10,000 loan with

the terms and the initial interest rates shown below (minus a discount or plus a premium recently used for the program, which discount or premium is set forth below), the maximum amount that the interest rate can rise under the program is shown below. The monthly payments can increase from the initial payment shown below to the maximum payment shown in the year indicated.

Program	Interest-Only Period (years)	Amortization (years)	Index Value (%)	Margin ⁽²⁾ (%)	Discount ^(d) Premium ^(p) (%) ⁽³⁾	Initial Rate (%) ⁽⁴⁾	Initial Int. Only Paym't ⁽⁵⁾	Adjustment Caps ⁽⁶⁾ (%)	Max. Rate ⁽⁷⁾ (%)	Max. Payment ⁽⁸⁾	Yr. Of Max. Payment
U.S. TREASURY											
10/1	10	30	4.72 ⁽¹⁾	2.75	1.125 ^(d)	6.250	52.08	5/ 2/ 5	11.250	104.93	11
7/1	10	30	4.72 ⁽¹⁾	2.75	1.375 ^(d)	6.125	51.04	5/ 2/ 5	11.125	104.07	11
7/1	7	30	4.72 ⁽¹⁾	2.75	1.375 ^(d)	6.125	51.04	5/ 2/ 5	11.125	100.59	8
5/1	10	30	4.72 ⁽¹⁾	2.75	1.375 ^(d)	6.125	51.04	5/ 2/ 5	11.125	104.07	11
5/1	5	30	4.72 ⁽¹⁾	2.75	1.375 ^(d)	6.125	51.04	5/ 2/ 5	11.125	98.92	6
3/1	10	30	4.72 ⁽¹⁾	2.75	1.375 ^(d)	6.125	51.04	2/ 2/ 6	12.125	110.98	11
3/1	5	30	4.72 ⁽¹⁾	2.75	1.375 ^(d)	6.125	51.04	2/ 2/ 6	12.125	106.25	6
3/1	3	30	4.72 ⁽¹⁾	2.75	1.375 ^(d)	6.125	51.04	2/ 2/ 6	12.125	104.24	6
1/1	10	30	4.72 ⁽¹⁾	2.75	1.625 ^(d)	5.875	48.96	2/ 2/ 6	11.875	109.24	11
LIBOR											
1ML	10	30	5.15 ⁽¹¹⁾	1.50	0.625 ^(d)	6.000	50.00	Lifetime	12 12.000	110.11	11
1-1L	10	30	5.15 ⁽⁹⁾	2.25	1.500 ^(d)	5.875	48.96	2/ 2/ 6	11.875	109.24	11
3-1L	10	30	5.15 ⁽⁹⁾	2.25	1.250 ^(d)	6.125	51.04	2/ 2/ 6	12.125	110.98	11
3-1L	5	30	5.15 ⁽⁹⁾	2.25	1.250 ^(d)	6.125	51.04	2/ 2/ 6	12.125	106.75	6
3-1L	3	30	5.15 ⁽⁹⁾	2.25	1.250 ^(d)	6.125	51.04	2/ 2/ 6	12.125	104.24	6
5-1L	10	30	5.15 ⁽⁹⁾	2.25	1.250 ^(d)	6.125	51.04	5/ 2/ 5	11.125	104.07	11
5-1L	5	30	5.15 ⁽⁹⁾	2.25	1.250 ^(d)	6.125	51.04	5/ 2/ 5	11.125	98.92	6
7-1L	7	30	5.15 ⁽⁹⁾	2.25	1.250 ^(d)	6.125	51.04	5/ 2/ 5	11.125	100.59	8
7-1L	10	30	5.15 ⁽⁹⁾	2.25	1.250 ^(d)	6.125	51.04	5/ 2/ 5	11.125	104.07	11
10-1L	10	30	5.15 ⁽⁹⁾	2.25	1.125 ^(d)	6.250	52.08	5/ 2/ 5	11.250	104.93	11
6ML	10	30	4.99 ⁽¹⁰⁾	2.75	1.250 ^(d)	6.500	54.17	1/ 1/ 6	12.500	113.61	11
2-6L	5	30	4.99 ⁽¹⁰⁾	2.25	1.375 ^(d)	5.875	48.96	3/ 1/ 6	11.875	104.40	6
3-6L	5	30	4.99 ⁽¹⁰⁾	2.25	1.125 ^(d)	6.125	51.04	3/ 1/ 6	12.125	106.25	7
5-6L	10	30	4.99 ⁽¹⁰⁾	2.25	1.125 ^(d)	6.125	51.04	5/ 1/ 5	11.125	104.07	9
7-6L	10	30	4.99 ⁽¹⁰⁾	2.25	1.125 ^(d)	6.125	51.04	5/ 1/ 5	11.125	104.07	11
10-6L	10	30	4.99 ⁽¹⁰⁾	2.25	1.000 ^(d)	6.250	52.08	5/ 1/ 5	11.250	104.93	11

- (1) One year Treasury constant maturity for the week ending 2/17/2006 (Fed Pub H.15, released 2/21/2006).
- (2) This is a margin we have used recently for this program; your margin may be different.
- (3) This is the amount of discount (d) or a premium (p) used recently for this program; your initial rate may be discounted or priced at a premium by a different amount.
- (4) Index Value plus Margin less Discount or plus Premium, rounded to the nearest one eighth of one percent.
- (5) During Interest-Only period: monthly payments of Interest-Only.
- (6) First Adjustment Cap/Subsequent Adjustment Cap/Lifetime Cap.
- (7) Initial Rate plus Lifetime Cap, or simply Lifetime Cap, if applicable.

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- (8) Includes Principal & Interest.
(9) London Interbank Offered Rates - one year, 2/28/2006, Wall Street Journal, Money Rates - 2/21/2006.
(10) London Interbank Offered Rates - six month, 2/28/2006, Wall Street Journal, Money Rates - 2/21/2006.
(11) London Interbank Offered Rates - one month, 2/28/2006, Wall Street Journal, Money Rates - 2/21/2006.
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You will be notified in writing at least 25 days, but not more than 120 days, before the due date of a payment at a new level. This notice will contain information about your interest rates, payment amount and loan balance.

To see what your payment would have been for any program during the Interest-Only period, divide your mortgage amount by \$10,000, then multiply the monthly payment by that amount. (For example, the initial monthly payment on a 5-1 Interest-Only ARM loan with an Interest-Only Period of 10 years for a mortgage amount of \$60,000 with a 30-year term would be: $\$60,000/\$10,000 = 6$; $6 \times \$51.04 = \306.24 .)

Additional information concerning Interest-Only Feature

If your ARM has an Interest-Only feature, prior to the expiration of the “Interest-Only Period”, your monthly payment will be comprised of interest only, calculated on the basis of your current interest rate applied to the outstanding principal balance of your loan (the “Interest-Only Payments”). No payments of principal will be due during the Interest-Only Period. **Your Interest-Only Payments will not reduce the principal balance of your loan, and you will not be contributing to increasing equity in your home. You may, however, make extra payments to reduce the loan principal at any time.**

If you make an extra payment during the Interest-Only Period, your loan will be re-amortized based on the reduced principal balance, when your next regularly schedule payment is processed. At the expiration of your Interest-Only Period, your monthly payments will be both principal and interest. The lender will determine the amount of the monthly payment that would be sufficient to repay the unpaid principal that you owe at the expiration of the Interest-Only Period, and all subsequent Change Dates, in substantially equal payments until your loan’s maturity date.

C. Construction Loan ARM Program (Term Greater Than 12 Months)

This disclosure describes the features of the Adjustable Rate Mortgage (ARM) program the lender offers for construction loans with the term greater than 12 months. If you are applying for a construction loan which

has an ARM interest rate feature (Prime Rate plus a margin) and a term of more than 12 months, this disclosure is applicable to you. This disclosure is not a commitment to make a loan to you, and it is not a contract or loan document. If your loan application is approved, the specific terms of your loan will be set forth in your Loan Documents. The following information will generally describe your ARM construction loan.

General Description of the Program

The principal amount of the construction loan will be advanced over the term of the loan in the form of one or more approved draws. There may or may not be an initial draw at closing. Your payments prior to maturity are “Interest-Only” payments; that is, your payments are in the amount of interest as it accrues, plus any applicable late charges or fees, but no principal of your loan is being paid. Consequently, your payments do not amortize your construction loan or reduce the principal balance of your Note. All principal advanced and unpaid, plus unpaid accrued interest and any other amounts owed in connection with your loan, will be due and payable on the loan maturity date, which is the date of the final payment is due as set forth in your Note.

How Your Interest Rate and Payments Are Determined

The interest rate for ARM construction loans is based on an index plus a margin. The interest rate will equal the current index plus the margin, up to a maximum rate of 18.00% or the state usury ceiling, whichever is less. The index for ARM construction loans is the Wall Street Journal Prime Rate, which is the “Prime Rate” published in the Money Rates column on *The Wall Street Journal, Western Edition* (the “Journal”). If for any reason this index is not available, your lender will use a new, comparable index. Ask your lender for the current index and applicable margin. The payment amount will be based on the interest rate and loan balances outstanding during the monthly period for which the payment is calculated.

How Your Interest Rate Can Change

The interest rate for ARM construction loans can change each time the index changes (called the “Change Date”). The new interest rate will be calculated by adding the index to the margin. This rate will be in effect until the Change Date, at which time a new interest rate will be calculated by adding the index to the margin. You could have more than one Change Date between payment dates. You will be notified in writing of a payment change resulting from a new interest rate(s) at least 25 days before the

due date of the payment. Your interest rate cannot increase above 18.00% or the state usury ceiling, whichever is less, at any time. If your loan is subject to a floor rate, then your interest rate will never be lower than the amount set as the floor rate. Ask your lender if a floor rate applies to your loan, and for the amount of the floor rate if it applies.

How Your Monthly Payment Can Change

Your monthly Interest-Only payment can increase or decrease substantially based on a change in the interest rate. The amount of your new payment will be due starting with the first monthly payment after the Change Date(s) and will continue until the amount of your monthly payment changes again. Your monthly payment will also change as construction draws are advanced, or due to other changes in the principal balance of your loan. This will be reflected on your billing statement. The following example demonstrates how your monthly payment can change.

On a \$10,000 loan fully advanced, with the terms and initial interest rate shown below, the maximum amount that the interest rate can rise under the program is shown below. The monthly payment can increase from the initial payment shown to the maximum payment shown at any time the index plus the margin is equal to or greater than the Maximum Rate.

Index Value (%) ⁽¹⁾	Margin (%) ⁽²⁾	Discount Premium ^(d) ^(p)	Initial Rate ⁽³⁾	Initial Payment	Max. Rate	Max. Payment	Years of Max. Payment
7.50	2.00	N/A	9.50	79.17	18.00 ⁽⁴⁾	150.00	See footnote ⁽⁵⁾

- (1) The Wall Street Journal Prime Rate in effect on January 31, 2006.
- (2) This is the margin Lender has used recently for the program; your margin may be different.
- (3) Index value plus margin.
- (4) The Maximum Rate will not exceed 18.00% or the state usury ceiling, whichever is less.
- (5) The Maximum Rate will occur if the applicable index plus the margin ever equals or exceeds 18.00% or a state usury ceiling, whichever is less, which could occur at any time.

You will be notified in writing at least 25 days, but not more than 120 days, before the due date of a payment at a “new” level. This notice will contain information about the index, your interest rate, the new payment amount, and your loan balance.

To see what your payment would have been during any period at this initial interest or the maximum rate, divide the loan principal outstanding by \$10,000; then multiply the monthly payments by that amount. (For example, the initial monthly payment on a construction loan balance

outstanding of \$60,000 would be: $\$60,000/\$10,000 = 6$; $6 \times 79.17 =$
\$475.02 per month.)

Interest Reserve

If your loan is set up with an interest reserve, the original loan amount may include all or a portion of the estimated amount of interest payments expected to become due over the term of the loan. In such cases, if the payment is to be paid from the interest reserve, the Lender provides the borrower notice of payment due and advises the borrower that the interest payment has been advanced from the loan proceeds.

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