

Week of August 29th, 2005

**Seattle Web Design Works**

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Gold	↓	\$420.10
10 Yr Bond	↑	4.162%
CRB	↓	\$311.28
Prime	→	6.250%
Libor	↑	3.810%
1 Yr T	↑	3.520%
MTA	↑	2.737%
COFI	→	2.622%
FNMA 60	→	5.580%

**Loans up to \$359,650**

Type	Trend	Rate	APR
30 Yr FIX	→	5.750%	5.836%
15 Yr FIX	↓	5.375%	5.506%
5/1	→	5.250%	4.309%
3/1	→	4.875%	4.097%

**Loans over \$359,650**

30 Yr FIX	→	5.875%	5.937%
15 Yr FIX	→	5.500%	5.601%
10/1	↑	5.750%	4.618%
7/1	↑	5.625%	4.572%
5/1	→	5.250%	4.292%

## The rate is good only while it lasts

Negative amortization (neg-am) loans serve some borrowers well, but they are not for everybody. In evaluating risks vs. rewards of a neg-am loan, borrowers must know how these loans work and must also have a clear picture of their financial situation now and in the future. This week we describe how neg-am loans work and next week we profile borrowers who can benefit from neg-am loans and borrowers who could be hurt by them.

Neg-am loans are actually quite simple. There are variations on the theme, such as the introductory rate itself, the length of time the introductory rate is applicable, and the amount of negative amortization allowed. An example follows.

Let's assume a \$500,000 loan; the 11th District Cost of Funds (COFI) index; a 2.875% margin; and 115% allowed negative amortization. The introductory rate is 1.5% and the introductory period is one month. The initial minimum monthly payment is thus \$1,725.60. This payment is the amount required to amortize \$500,000 over thirty years at 1.5%. But as the headline states "the rate is good only while it lasts," which is one month.

The good news is that you need only pay this minimum payment each month for the first year. The bad news is that if you elect to make only the minimum payment you incur negative amortization. Here's how that happens. After the introductory period, the rate changes each month based on the index plus the margin. The COFI index is 2.676% today and the margin is 2.875%. If the introductory rate period ended today, the new rate would be 5.551%.

On your next payment date you have

three options: pay the minimum \$1,725.60; pay \$2,312.92 interest only; or pay the \$2,854.97 fully amortizing payment. The interest only and fully amortizing payments are calculated based on 5.551% interest rate. If you make the \$1,725.60 minimum payment, the difference between that and \$2,313.92 accrued interest is added to your loan balance as deferred interest. Thus your loan grows by \$588.32. That is called negative amortization.

Each month the index, and therefore the interest rate, changes. Each month you get the same three options: minimum payment; interest only payment; or amortizing payment. The minimum payment remains fixed for one year, at which time it will increase by 7.5%, and will increase by 7.5% each year for the first five years. Thus, regardless of what happens to the COFI index, the minimum payments are: \$1,725.60 for year one; \$1,855.02 for year two; \$1,994.15 for year three; \$2,143.71 for year four; and \$2,304.49 for year five.

At the end of five years or if the loan balance reaches 115% of the original amount (\$575,000) whichever occurs first, the minimum payment and interest only payment options go away. You must make payments necessary to amortize the loan over the remaining twenty five years. And since the interest rate changes each month, the payments will also change.

So that's pretty simple. That's essentially how neg-am loans work. Next week we discuss the pros and cons of the neg-am loan for different borrowers – who it can help and who it can hurt. Or maybe that should be "whom?"

**Rates shown are effective 9:00 AM the above date for a 30 day lock, zero points, and for a purchase loan. Rates can change without prior notice. Arrows show a one week trend. Diversified Capital Funding is a broker licensed by the California Department of Real Estate. License #01258060.**