# the Mortgage Bulletin

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Your name

| Conforming Loans to $359,650 | | | |
|---|---|---|---|
| **Type** | **Rate** | **APR** | **Trend** |
| 30 Yr FIX | 5.875% | 5.956% | ➜ |
| 15 Yr FIX | 5.625% | 5.506% | ➜ |
| 5/1 | 5.625% | 6.293% | ↑ |
| 3/1 | 5.500% | 6.371% | ↑ |
| **Jumbo Loans above $359,650** | | | |
| 30 Yr FIX | 6.250% | 6.311% | ↑ |
| 15 Yr FIX | 5.875% | 5.973% | ➜ |
| 10/1 | 6.000% | 6.1293 | ➜ |
| 7/1 | 6.000% | 6.359% | ➜ |
| 5/1 | 5.750% | 6.337% | ➜ |
| 10 Yr Bond | | 4.361% | ↑ |
| Prime | | 6.750% | ➜ |

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## What is an index?

Once in awhile we are asked the question posed in the above headline. So today we answer it. In the context of mortgages, an index is a figure used as a basis for establishing interest rates on adjustable rate mortgages (ARMS).

The index plus a margin determines the fully indexed rate. The margin is a fixed number. It never changes. The index is a reflection of the economy, and therefore it will change. The most frequently used indices for standard ARMS are arranged below from the (historically) more stable to the more dynamic.

COFI. (The cost of funds index is the weighted-average interest rate paid by 11th Federal Home Loan Bank District savings institutions for savings and checking accounts).
Treasury Average. (An index determined by the monthly average of one-year Treasury bills).
One Year Treasury. (An index published by the Federal Reserve Board based on the average yield of a range of Treasury securities, all adjusted to the equivalent of a one-year maturity).
Libor. (The London Inter Bank Offer Rate. It's the rate of interest at which banks offer to lend money to one another in the wholesale money markets in London).

In addition to the above indices, the WSJ Prime Rate (the rate at which banks will lend money to their most-favored customers) is used -- sometimes for standard mortgages -- but most typically for home equity lines of credit.

It is helpful to know not only WHAT these indices are but also WHY they are. Above are examples of WHAT they are. Following is a discussion of WHY they are -- their reason for being.

Lenders have a product. The product is money – money to lend. Essentially they offer their product in different packages so as to appeal to different needs and preferences of different borrowers.
In order to stay in business, they must make a profit on their loans. So, they price their loans so as to give them a return sufficient to make a profit, after the effect of any inflation.

It is the relationship between interest rates and inflation that results in thirty year fixed rate loans bearing higher interest rates than initial rates for adjustable rate mortgages. The longer the fixed term of a loan, the more risk to the lender that inflation will erode part or all of its profit. By shortening the fixed term from thirty years to a 10/1, 7/1, 5/1, or a 3/1, the risk to the lender is lowered and the initial rate can be lowered.

But then some agreed upon formula must be used to determine the rate beyond the initial fixed rate period. That's where the index comes into play. Index plus margin. The more closely and accurately the index responds to economic changes, particularly inflationary pressure, the greater the security to the lender. Conversely, the more stable indices tend to give the borrowers more security if inflation occurs.

When determining which type loan to take and which index to use, borrowers must have a basic understanding of how each index performs vis-à-vis economic trends. And they must form some assessment about what they expect the economy to do in the future.

We address the index performance only tangentially in this bulletin by arranging the indices from stable to dynamic. We will be pleased to discuss each index in detail. Just give us a call.

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