



Mortgage Insight: Introducing the Payment Option ARM

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Make a 30 or 15-year amortization payment. Already have enough equity in your home and don't want to pay it down anymore – pay only interest.

Monthly Payment Options:

- 1. Minimum payment option:**
Keep more cash now with a low fixed payment amount.
- 2. Interest-Only payment option:**
The most affordable way to invest in a larger home.
- 3. 30-year fully amortized:**
Pay off your mortgage faster.
- 4. 15-year fully amortized:**
Pay off your mortgage even faster.
- 5. Additional Principal Payments:**
Anything you want to add on top of interest-only payment to lower your balance and next month's payment.

Option ARM payments are recalculated based on the actual balance every month. Making a payment towards the principal will *immediately* result in a change to your payment schedule, and you will see lower monthly payments starting the next month.

Deferred Interest Feature

If you consistently choose to make minimum payments, you may eventually incur what is called "deferred interest." This is a feature which allows you to defer interest at no cost. You can carry deferred

interest for up to five years, and then you will have a choice of either paying it off or adding it to your principal balance. If you do use this feature, you can pay off deferred interest at any time within a five year period. The year you choose to repay it, you can take a tax deduction for the entire amount of the payment.

This, by the way, has a useful side effect: if your tax bracket is low now but is expected to increase, it makes sense to pay interest later and save more on taxes. The scenario with possible deferred interest and its repayment will repeat every five years.

If the concept of having deferred interest that may be added to your principal balance makes you uncomfortable, think of what happens when you take out a home equity line of credit and use it for various purposes - something that a majority of home owners do. What you are doing is increasing the debt against your home, except at rates that are higher than what you would see with an Option ARM product.

What's the Rate?

You start with a very low introductory rate of 1.0% to 1.99% on residential, and 1.99% to 2.99% on investment properties (in most cases.)

Your fully amortized first month's payment (principal and interest calculated for 30 years at the introductory rate) sets the amount of the minimum payment option.

Starting from the second month, the actual rate is equal to the

The Payment Option ARM is a very powerful mortgage solution that allows borrowers a choice of several types of payments every month. This product has enough features to talk for a day, but for now I'll mention that it is an adjustable rate mortgage (ARM) with an extremely low rate. The loan's rate is based on the stable and predictable 12-Month Treasury Average (MTA) index.

The actual rate on an Option ARM is based on the 12 month *moving average* of the Treasury Index, not just where it is on any given day. Because of the 12 month averaging, the rates move up and down much slower than on traditional ARMs that are directly based on where the LIBOR, Treasury, or similar index is at any given moment.

Flexible Mortgage Payments

Unlike other mortgage products, an Option ARM gives you many choices. Every month you can choose between a fixed minimum payment, an interest only payment, and a 30 or 15-year amortization payment. *What does this buy you?* Plenty. Need cash for something else this month? Opt for a minimum payment. Received a bonus check?

12-Month MTA index plus margin. The margin stays fixed for the life of the loan, while the index may vary depending on market conditions. The amount of your minimum payment option, however, stays fixed.

The Security of a Fixed Minimum Monthly Payment Option

The Minimum Payment option offers a low fixed payment calculated at the start rate. The amount is usually fixed for one year and can not typically increase or decrease by more than 7.5% next year (if your payment is \$1,000 now it will not be higher than \$1,075 next year, and so on.)

New loan programs are now available that have a fixed minimum payment for five years. This offers a level of security not available with other mortgage products, where your obligation is always principal plus interest at rates higher than an Option Arm's.

A Payment Option ARM gives you the financial flexibility that should something happen to your budget, such as a pay cut or unexpected expense, you can revert to making minimum payments until the situation improves.

Example:

New loan of \$300,000

(Based on MTA Index of 4.98%, Margin of 2.01% and typical start rate of 1.0%)

Payment Options:

1. **Minimum payment** (fixed for 12 months) = \$965.39 per month.
2. **Interest Only** = \$1,747.50 per month.
3. **30-Year Fixed** fully amortized Payment = \$1,994.06 per month.
4. **15-Year Fixed** fully amortized payment = \$2,695.44 per month.

Cash flow savings of Option ARM minimum payment over traditional 30 year P&I loan at 6.5%:

per month: \$930.99
per year: \$11,171.94
over 5 years: \$55,859.69

Who should consider a Payment Option ARM?

- Anyone who can afford to take a little risk and gain tremendous rewards.
- Self-Employed or people with variable monthly incomes.
- Real estate investors wanting to keep their mortgage payments to an absolute minimum.
- People who have better- higher return- ways to invest their money than in their homes.
- People who've chosen to have the very lowest mortgage payment available.

Summary:

Pros and Cons of Option ARMs

Pros: Very low rate, flexible payment structure, fixed low minimum payment. The lowest monthly payment of any currently available mortgage product.

Cons: Rate can increase (but slower and not as much as other indexes.)

***Claudio D. Varga** is President of My Home Loan. The firm provides a wide variety of lending solutions for residential and commercial real estate. Claudio has been a licensed mortgage broker and consultant since 1998 and his clientele ranges from first time home buyers to professional multi-property real estate investors.*

Claudio and My Home Loan are proud members of both the Irvine and U.S. Chambers of Commerce.

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