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The Fed, LIBOR, Sub-prime & the Housing Market

Answers to how the Fed's rate cut will positively impact home owners and buyers

ANN ARBOR, MI – January 31, 2007 – The Fed lowered the Federal Funds rate from to 5.25% to 3% through a series of recent actions from September 18, 2007 through January 30, 2008. This is the rate that banks charge each other for lending short term funds here in the United States, and will have a direct impact on two other rates that affect home owners and buyers:

- Prime rate – Prime is set at 3% above of the Fed funds rate (6%) and is the base retail rate that banks use for home equity lines of credit and business loans. Therefore, if you have an adjustable rate home equity line of credit, your interest rate will go down as a result of the Fed's actions.
- LIBOR rate – The London Interbank Offered Rate (LIBOR) is the rate that banks charge each other for lending short term funds anywhere outside of the US, primarily in the London money markets. If you are a bank in need of short-term funds, you could borrow money from other banks in the US using the Fed funds rate, or you could borrow money from any bank in the world that deals in the money markets. Borrowing from the money markets is a more flexible option primarily because banks these days do business globally with many sources as opposed to doing business only in the US with limited sources. The London money market is the largest and most fluid of all other money markets, so LIBOR is the most accurate measure of banks' borrowing costs available today. Therefore, LIBOR is used as the "index" or base rate on most adjustable rate mortgages in the United States. If your adjustable rate mortgage is tied to LIBOR as most are, your rate will go down as a result of the Fed's actions.

The Fed, LIBOR and Sub-prime:

"LIBOR was the primary index used on most sub-prime adjustable rate mortgages (ARMs)", said Gibran Nicholas, Chairman of the CMPS Institute, an organization that certifies mortgage bankers and brokers. "Therefore, after the fixed period expires and these interest rates adjust, the new interest rates and payments will be based on LIBOR." Before the Fed started lowering rates in September, the one-month LIBOR rate was 5.8% and the 12 month LIBOR was 5.2%. This meant that if your subprime loan had a margin of 4% above either the

1-month or 12-month LIBOR, your rate would have adjusted to 9.2% - 9.8% after the fixed period expired. Compare this with the current situation. The series of Fed rate cuts since September has driven the one-month LIBOR to 3.14% and the 12 month LIBOR to 2.97%. This means that if your subprime loan had a margin of 4% above LIBOR, your rate would adjust to 6.97% - 7.14% under current market conditions.

Here is a comparison of a \$200,000 sub-prime ARM that adjusts with 28 years remaining (most sub-prime loans were 30-year ARMs that adjust after the initial two-year fixed period):

- Formerly, before the Fed rate cuts and the corresponding reduction in LIBOR:
 - o Your mortgage payment would have gone up to somewhere between \$1,661 and \$1,747 per month.
- Now, after the Fed rate cuts and the corresponding reduction in LIBOR:
 - o Your mortgage payment would go up to \$1,356 - \$1,378

In other words, the recent Fed actions have resulted in literally \$300 - \$400 in monthly savings for a sub-prime borrower with a \$200,000 ARM that is going through a rate adjustment!

What the Fed can't control:

Rates on fixed-rate loans, jumbo mortgages, stated income mortgages, investment property loans, and all mortgages that are not based on LIBOR or Prime will not be directly impacted by the Fed's decisions. "The rates on these loans are tied to the mortgage backed bonds that trade on the bond market and will be affected by market conditions and economic news such as the monthly inflation and jobs reports," Nicholas said.

Interest rates on certain fixed rate mortgages for borrowers with good credit have gone down recently due to favorable conditions for these types of bonds in the financial markets. "If your mortgage loan is not tied to LIBOR or Prime, watch for a new economic stimulus package that will increase loan limits on conforming and FHA loans in high cost areas, and various economic reports that will affect the conditions in the bond market," Nicholas said. "In all cases, it is advisable to work with a Certified Mortgage Planning Specialist who can help you navigate the current market conditions," he says.

About CMPS Institute □ CMPS is a training, examination, certification and ongoing membership program for financial professionals who provide mortgage and real estate equity advice. The CMPS Institute was formed as a joint effort by leaders in the mortgage and financial planning industries to raise professional standards among mortgage professionals and integrate sound financial planning

advice into the mortgage process. Recognized for its preeminence within the industry, the CMPS curriculum represents the core knowledge expected of residential mortgage advisors, regardless of the diversity of specializations within the industry. For more information, please visit www.CMPSInstitute.org or call 888.608.9800.