

# Home Financing Strategies



## Overcoming Deferred Interest Concerns in a Rising Interest Rate Environment

Many borrowers may not see the potential advantages of the Cashflow Option Loan's minimum payment option in an increasing interest rate environment. It seems when rates begin to rise, there is a fear around the negative effects of deferred interest. Borrowers worry that by making a minimum payment, they may be deferring interest and placing themselves in a potentially negative equity position with their property. The example below illustrates the effects of making the minimum payment in a rising interest rate environment. In this example, the following assumptions are applied:

- Purchase Price: \$500,000
- Initial Loan Amount: \$400,000 (based on 80% LTV)
- Loan Holding Period: 5 years
- Property Appreciation Assumption: 3% per year
- Current LIBOR index: 1.423%\*
- Start Rate for Minimum Payment: 1.95%\*
- Minimum Payment Increase/Decrease cap: 7.5% annually
- Margin: 2.0%
- Index Increase Assumption: .25% every 3 months for the first 3 years of the loan

As you can see from the chart and graph below, even when choosing to make the minimum payment every month, borrowers may not begin to see an increase in their original principal balance until year 4. Additionally, you will see that even with modest property appreciation of 3% per year, the borrower's Loan-to-Value ratio continues to decline over the 5-year mortgage holding period.

Year	Year End Fully Indexed Rate	Minimum Monthly Payment	Annual Minimum Payment	Year End Loan Balance	Annual Interest Required	Annual Interest Paid	Annual Deferred Interest	Property Value	Loan to Value
1	4.125%	\$1,469	\$17,622	\$396,827	\$14,449	\$14,449	\$0	\$515,000	77%
2	5.125%	\$1,579	\$18,944	\$396,715	\$18,832	\$18,394	\$438	\$530,450	75%
3	6.125%	\$1,697	\$20,364	\$399,211	\$22,860	\$20,364	\$2,496	\$546,364	73%
4	6.375%	\$1,824	\$21,892	\$402,874	\$25,556	\$21,892	\$3,664	\$562,755	72%
5	6.375%	\$1,961	\$23,534	\$405,088	\$25,747	\$23,534	\$2,213	\$579,638	70%

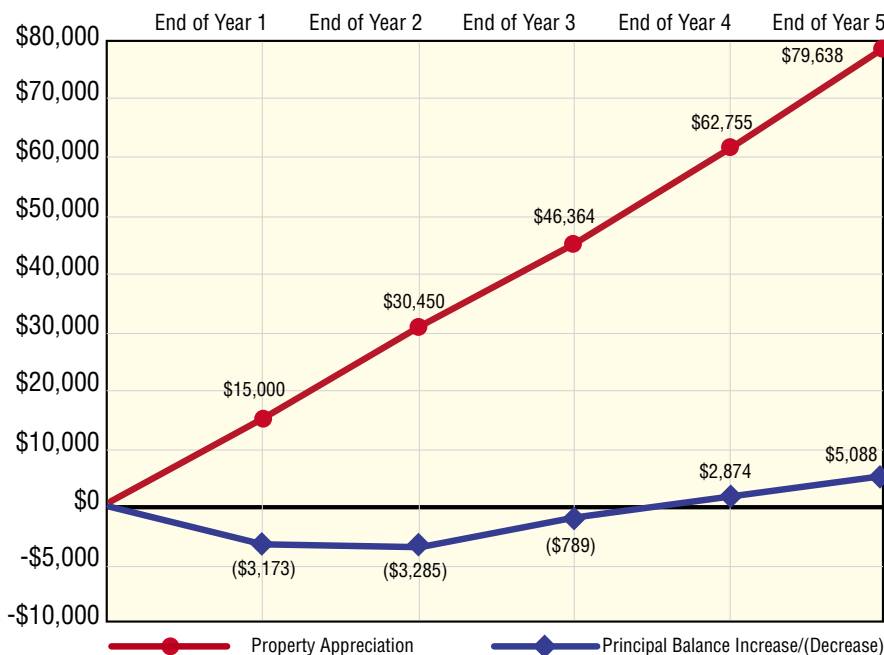
### Year 5 Summary

**Loan Balance**  
\$405,088

**Property Value**  
\$579,638

**Loan-to-Value**  
70%

**Equity Position**  
\$174,550



## IMPORTANT DISCLOSURES

The following example illustrates payment terms for a 30-year adjustable-rate Cashflow Option 1-year Fixed Payment Loan based on a \$500,000 home purchase with a 20% down payment, a \$400,000 mortgage and a discounted Interest Rate of 1.95% for the first month, in effect as of 12/31/02. The Interest Rate adjusts monthly based on the 1-month LIBOR index plus a Margin, set at 2% in this example. With a 1.423% LIBOR rate, this would make the fully indexed Rate 3.375%, which is a 3.405% annual percentage rate. (The APR may vary.) The following payment examples also assume that the fully indexed rate, the Index plus the Margin, remains constant throughout the life of the loan; rates can increase during the life of the loan, however, as the example on the first page of this document illustrates. Rates used in this example are not guaranteed and are subject to change without notice.

Using the same assumptions as above and a fully indexed rate that remains constant throughout the life of the loan, here are examples of the payment choices:

- The Minimum Payment for the first year would be \$1469 based upon the discounted 1.95% Interest Rate. After the first year, the Minimum Payment could increase, but any increase would be limited to 7.5% each year until the end of the 5th year, and every 5th year thereafter, when the Minimum Payment is recalculated using the current fully indexed rate without regard to the 7.5% payment cap.
- The Interest-Only Payment option is not available for the first month. For the remainder of the first 15 years, the payment would be \$1123 at the fully indexed rate. The Interest-Only Payment option is not available, however, when the Interest-Only Payment would be less than the Minimum Payment. After the first 15 years of the term of the loan, the Interest-Only Payment option is no longer available.
- There is also the option of making amortizing payments based upon a 30- or 15-year term beginning in the second month. For the 30-year term, such a payment would be \$1768 at the fully indexed rate. For the 15-year term, the payment would be \$2841 at the fully indexed rate.

Payments may revert to fully amortizing over the remainder of the loan term if the outstanding loan amount reaches 110% of the initial loan amount due to deferred interest.

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