Institutional disparities in the pricing of adjustable rate mortgage loans

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Andrea Jane Heuson[1]

Abstract

In recent years, commercial banks and savings and loan associations in South Florida have consistently offered initial adjustment period "teasers," or subsidies, on their adjustable rate mortgage loans (ARMs). This study adopts the size of the initial subsidy as a proxy for a lender's willingness to offer ARM loans and develops an econometric model which relates the size of the teaser to a series of internal variables (other lending parameters), and external variables (financial market conditions).

The results suggest that subsidization policies are not identical across institutions. Specifically, savings and loan associations seem to be less willing than commercial banks to accept the interest rate exposure inherent in ARM lending when future loan rates are constrained by adjustment limits. Consequently, the study argues

that the character of a lender's existing assets influences its reactions to the risk/return properties of new assets.

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Author information

Authors and Affiliations

Department of Finance, University of Miami, School of Business, Jenkins Building-514, 33146, Coral Gables, Florida

Andrea Jane Heuson

Additional information

This paper has benefitted greatly from the comments of the Journal's reviewers. Responsibility for remaining errors rests with the author.

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