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Do You Have an Adjustable Rate Mortgage? Here's Some Useful Information

I recently received a call from a reader asking what is likely to happen with his adjustable-rate mortgage (ARM) that is tied to the LIBOR Index. LIBOR may be just another acronym that you've skipped over in the sea of real estate acronyms, but if you have an ARM read on, because the "index" (LIBOR) that is used to set your interest rate is being phased out after 2021. I asked **Jaxzann Riggs,** owner of **The Mortgage Network** what borrowers should expect.

LIBOR, or the London Interbank Offered Rate, was a benchmark interest rate index used for decades by lenders all around the world, as a predictor of future loan costs. To break it down, LIBOR was calculated based on estimates of the average interest rate a group of leading global banks would charge each other for short-term loans. Lenders then used that information (referred to as the "index") to calculate the rate you would pay for your mortgage as the interest rate on your ARM was "adjusted."

During higher-priced housing markets, many homeowners chose an adjustable rate mortgage because they preferred the lower monthly payments that an ARM offered. Most ARMs created in the past 20 years were tied to the LIBOR benchmark, which is why this index has played an important role in how much interest you pay on your mortgage if you have an ARM.

The LIBOR index, as I said, is being phased out. Introduced in 1986 by the British Bankers' Association, the LIBOR index quickly became the default standard interest rate used by both local and international lenders. Despite wide acceptance, LIBOR was based on self-reporting and good faith estimations, which made it very susceptible to manipulation and fraud. Scheming and collusion within the LIBOR index were brought to light in 2012, causing distrust, tighter regulations, and the beginnings of a plan to create a new system.

Introducing… SOFR, the Secured Overnight Financing Rate (pronounced "so-far").

Effective January 3, 2022, the mortgage industry began to adopt SOFR. SOFR is a benchmark rate that uses the rates banks are charged for their overnight transactions. This system helps deter manipulation and subjectivity, as it is based on transactions secured by U.S. Treasuries.

What does this mean for you?

Absolutely nothing if you have a fixed-rate mortgage. However, if you have an adjustable rate mortgage, you might see changes in your upcoming bills. ARMs typically adjust annually and as LIBOR-based ARMs hit reset, the new SOFR index is likely to be used to calculate your new rate. When SOFR ARMs reset, they will be adjusted every six months, the reason being that the 1-year LIBOR looks forward, while SOFR looks backward. LIBOR reflects where interest rates are expected to go in the next 12 months, while SOFR reflects an average of short-term rates during a recent 30-day period.

Jaxzann told me that LIBOR and SOFR rates should be close to each other. "It won't be identical but within the margin of a homeowner's perspective, it should be a minimally different."

I agree that the switch from LIBOR to SOFR is going to have a relatively limited effect on most borrowers, but as with all things, knowledge is power and consumers who have an ARM should contact their loan servicers to discuss the changes that they can expect.

So, take a deep breath and remember, you are not alone in this! Reach out to **Jaxzann Riggs** at **303-990-2992** to discuss the implications that SOFR will have on your existing ARM or the future benefits that you might enjoy by having an ARM.