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An ARM May Keep You from Paying an Arm and a Leg

Let's Talk Home Financing

By Jim Smith Realtor®

As mortgage interest rates rise, many potential homebuyers have asked me about the wisdom of using an adjustable-rate mortgage loan (often referred to as an ARM) to finance their home purchase.

Adjustable-rate mortgages, also known as "variable-rate mortgages" are mortgages that offer a low introductory interest rate for a specific period of time. The borrowers' interest rate and correspondingly their monthly principal and interest payment will be "locked in" for the first five, seven, or ten years. For example, a 10/6 ARM means that you will pay a fixed interest rate for 10 years, then the rate will adjust every 6 months. A 7/1 ARM, on the other hand, means that your rate will be fixed for 7 years and then the rate will adjust every year.

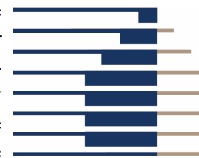
Because the lender is not "locking in" the interest rate for a 30-year period, the borrower is sharing in the risk associated with rising rates. In exchange for the ability to increase the borrowers' rate based upon future market conditions, lenders offer lower rates for ARMs than they do for 30-year fixed rate loans. The lowest ARM rates are offered on shorter terms, as an example, a 5-year ARM will have a lower rate than a 10-year ARM. The difference in today's pricing for a 5-year ARM versus a 30-year fixed rate is approximately .75%, with a 5-year ARM being offered at 4.25% and a 30-year fixed rate loan being offered at 5.00%

Borrowers considering an ARM should know which index will be used to calculate their new interest rate, as well as the "margin" that will be added to the indexed rate to determine the "fully indexed interest rate" at the time of adjustment. While this might seem extraordinarily risky, all loans offered thru FNMA and FHMLC (and most jumbo lenders as well) "cap" the increases that can occur at each adjustment period as well as the maximum amount that the rate may increase over the life of the loan. Unlike the ARMs of previous years, borrowers are not allowed to make partial interest payments, so there is no risk of the loan amount increasing as the rate increases.

The most obvious benefit to choosing an ARM is lower monthly payments. While homebuyers will have to qualify for the loan based on the future higher payment price, they can take advantage of the lower payments by investing the savings somewhere with higher gains, making home improvements, or adding more to the principal balance to pay off the loan more quickly.

ARMs are typically best suited for borrowers who do not anticipate that they will still own the home at the time of the initial adjustment or those who anticipate increases in income that will keep pace with interest rate increases. If a borrower's circumstances change, there is always the option to refinance into a fixed rate loan. Unlike ARMs of the past, there are no longer prepayment penalties to dissuade the borrower from refinancing once the initial fixed interest rate ends. If you decide to refinance from an ARM to a fixed-rate mortgage, the refinancing process is straightforward and is similar to when you purchased your home. When you refinance, you take out another loan that is used to pay off your original note, then your new payments are based upon the new loan.

As the housing market continues to change, **Jaxzann Riggs**, owner of **The Mortgage Network**, is available to answer questions and help you decide which loan options are best suited for your current needs.



You can reach out to Jaxzann with any questions at **303-990-2992.** Mention that I suggested you contact her.