

Fact or Fiction?

Realities of Your Adjustable Rate Mortgage

You've heard all the hype surrounding adjustable rate mortgages in the past year and if you're like most people it probably serves to confuse more than inform you about what to do, if anything. A huge amount of adjustable rate mortgages or ARM's are ending their fixed rate periods and will enter an adjustment period this year, which is why you've heard the news. Does this mean that you have to refinance your ARM if you have one? The short answer is no, but now is a perfect opportunity to review what you have and see if it is still working for you and not the other way around.

Let's start with the good news. If you have an ARM currently, congratulations, you've saved a significant amount of money over a 30-year fixed rate. In fact, if you originated your ARM in the last few years you may have gotten some of the lowest rates in history. It's not uncommon for me to see clients who have rates in the mid 3% range. It's precisely for this reason that it may make sense to keep your current mortgage in place instead of refinancing.

But that's only half the story. The rate will cause the payment to go up on its own, but you also have to figure that the loan that was 30 years long now has only 25 years left to repay. If you consider both those factors you will see that the new payment for year six will be \$1,354.50. That's a 30% increase in your payment. Quite a difference from your original payment and you can see why this is causing some issues for people.

Different loan programs have different limits on how much your rate can increase, which may keep your payment lower; also it could be less than what a new loan payment may be. This is why it's important to look at the whole picture to make a decision on what's best for you.

Let's begin with a review of how ARM's work. I'll stick with a 5 Year Adjustable Rate Mortgage for the purposes of this exercise. Let's say you have a 5/1 ARM on a \$200,000 loan at 4% that you originated in December of 2002. You would have a principal and interest payment of \$954.83 per month. That payment would not change for the first five years, but in December of 2007 the loan would enter the adjustment period. The lender is now going to set your new rate for the 6th year. They get the rate for the next year by taking a financial index (index) and adding a buffer (margin) to it to get your new rate. The most commonly used index is LIBOR which is currently at around 5.4% and the most common margin is 2.25%. The financial index is constantly moving and is the variable number in the rate equation. The margin will always remain constant. If this loan were adjusting today your new rate would be 7.65%.

Who knows, you may be in great shape. It certainly can't hurt to call and figure it out with someone who you can trust to give you the real picture instead of all the hype. Call today for a free consultation and if it makes sense to refinance I'll help by giving a \$500 credit off your closing costs.



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