To ARM or Not to ARM?

Over the past several years, with interest rates still relatively low, many homebuyers have turned to fixed-rate mortgages. However, if rates creep higher, **adjustable rate mortgages (ARMs)** may experience wider interest because they generally start off with a lower interest rate than a fixed-rate mortgage.

With today's rate structure, it may be worth investigating the attributes of using an ARM. It is also worth noting that if rates rise, an ARM may cost you more over an extended period of time than a fixed-rate mortgage. This is because many ARMs are offered with a low introductory rate for a limited period of time. After the introductory rate expires, the rates can increase or decrease according to changes in the prime rate.

Consideration should also be given to the ARM cap (how much the interest rate can increase in a year) and the ceiling (the maximum interest rate for the life of the loan).

In effect, an ARM makes the buyer vulnerable to rising interest rates, while a fixed-rate mortgage requires the lender only to deal with the risk of rising rates. However, many ARMs do provide the option for converting to a fixed-rate mortgage at any time, without closing costs but with a nontax-deductible conversion fee.

The Bottom Line

If you are planning to apply for a mortgage you should consider the following important factors:

1. Compare interest rates both long- and short-term.

2. Determine the affordability. It may be more difficult to qualify for a fixed-rate mortgage than for an ARM. Fixed-rate mortgages generally require more cash outlay upfront.

3. After comparing the rates and affordability requirements of both mortgages, if you feel an ARM is in your best interest, be sure to include the option to convert to a fixed-rate mortgage at a future time.

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