Mortgage Basics

Many people dream of owning their own home, but the high cost of homes generally requires a home mortgage to make this become a reality.

Adjustable Rate Mortgages

Adjustable-rate mortgages (ARMs) are the second major type of loan available. With an ARM, your interest rate, and therefore your payment, can go up or down through the life of the mortgage, depending on various economic factors.

The rate is usually tied to a **money market index**, most commonly the one-year Treasury bill. The lender will usually add between two and four percentage points to the current rate for the Treasury bill to come up with your current adjustable rate. These extra percentage points are called the **margin**. The rate for an ARM mortgage usually begins lower than the fixed-rate mortgages available at the same time, sometimes by as much as two percentage points. This depends on the economic conditions at the time. The terms of the rate adjustments, including when they begin and how often they occur, will be specified in the terms of the loan. __The amount of time before the first rate change ranges from one month to ten years, but one year is the most common. If rates drop, your payment could go down, but if they go up, your payment will go up also. ARMs do usually have a **cap**, which states the maximum amount a rate can change at one time, and the maximum amount it can vary from the original rate over the life of the loan. A few ARMs also come with a **payment cap**, which states the maximum amount the payment can go up over the life of the loan. This is stated in dollars and not percentage rates. Some ARMs also include something called a **conversion option**. It allows you to convert the adjustable rate mortgage to a fixed rate mortgage at some point in the future for a set fee. This is a good thing to check on, in case interest rates begin to rise.

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