

# State Department Federal Credit Union

## Topics of Interest

### Should I choose an Adjustable Rate Mortgage?

As a general rule, if you plan to own your home four years or less, an Adjustable Rate Mortgage (ARM) will be more economical. If interest rates remain relatively stable or decline, the ARM remains a winner over the long run.

Despite many advantages, ARMs are not for everyone. They tend to be slightly easier to qualify for than a fixed rate loan, but you must be comfortable that your income will increase enough to handle potential payment increases. In addition, you might not be comfortable with the idea that your payments may change.

There are several features that you look for in an ARM loan.

- **Margin** - Look at the size of the margin. The smaller the margin the better. The margin is an amount added to the index to calculate the new rate and is constant over the term of the loan.
- **Index** - The index is a measure of interest rates outside the control of the lender. As the index moves up or down, so does the interest rate of the loan.
- **Caps** - There are several types of caps. Payment caps limit the amount a payment may increase. Interest rate adjustment caps limit the amount the rate may change.
- **Conversion Option** - This allows a borrower to convert the loan to a fixed rate at some future time. A fee may be charged if the option is exercised.
- **Rate Change Frequency** - This determines how often rate and payment changes will occur. There are many plans on the market with a possible rate change occurring as often as monthly. Annual changes are the most common.
- **Negative Amortization** - This occurs when monthly payments are too small to pay the principal or interest reductions. As a result the principal balance increases by the amount of unpaid interest and the interest on that interest. In short, the money you owe increases over time rather than decreases. This sometimes occurs with loans with payment caps but no interest rate caps.