

# KNOWLEDGE BASE

## The Truth about Adjustable Rate Mortgages (ARMs)

Mobium Mortgage is a full service lender capable of matching you with a mortgage that will suit your specific financial needs. If you determine that an Adjustable Rate Mortgage will best serve those needs, we thought that it would be helpful to explain what too often is not explained by many lenders; how and when do ARMs adjust?

After the “initial” fixed rate period has expired (typically after 3, 5, or 7 years), your lender will notify you of the adjustment that will soon take place (usually 60 days before). After the first adjustment, most ARMs will adjust every year thereafter. In other words, your new interest rate will typically be fixed for only 12 months (essentially it becomes a 1 Year ARM). Importantly, the new adjusted rate will be based on your loans “**Index**” plus your loan’s “**Margin**”. Although U.S. Treasuries have been used as an Index on some ARMs, the most common Index used today is the **LIBOR** Index. LIBOR stands for the London Inter-Bank Offering Rate, and is used because of its ability to closely track a bank’s cost of funds.

When it is time for your ARM loan to adjust, your lender will take the current LIBOR Rate (Index) and add it to your “Margin”. As you can see the “margin” is a very important feature of your ARM loan and **should be something that you should be concerned about whenever you ask for an ARM loan**. After the Index is added to your margin, the lender is then permitted to round up to the nearest 1/8<sup>th</sup> (.125%) of a percent.

A typical “margin” for an Adjustable Rate Mortgage is 2.25%. But...you can find margins up to 6.00% or higher (ask about a very competitive 1.50% margin on our 5 and 7 Yr. ARM). You will need to refer to your “**Adjustable Rate Mortgage Disclosure**” to discover what the margin is on your ARM. The “Adjustable Rate Mortgage Disclosure” is required to be given to you when you make application for an ARM loan. Be sure to ask for this Disclosure and review the terms of the ARM loan that you have applied for.

To give you a clear example of how an ARM loan will adjust, consider the following:

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- Loan:** Five Year Adjustable Rate Mortgage (Also called a 5/1 ARM, meaning that it is fixed for Five years and then reverts to a One Year Adjustable Rate Mortgage after the first adjustment)
- Index:** LIBOR (1 Year Average)
- Margin:** 2.25%
- Caps:** 5-2-5 (Meaning that your initial adjustment can't exceed 5%, your subsequent annual adjustments cannot exceed 2% each year, and over the life of your loan the rate can never go higher than 5% over your start rate).

If in this example, the loans initial "fixed" period (5 Years) was set to adjust this month, the lender will perform the following calculation:

LIBOR Index:	5.448%	
Plus Margin:	<u>2.250%</u>	
Total	7.698%	
Rounded up	<b>7.750%</b>	Your new rate for the next 12 months.

As you can see, your **margin** becomes the most important feature of an Adjustable Rate Mortgage **after** the loan has exceeded its initial adjustment period. It is very important that you trust your mortgage lender to provide you with a competitive low margin. Because a higher margin will often result in your loan officer making a higher commission, I would encourage you to call your Mobium Mortgage Planner, to exam what a fair and competitive margin is for your particular circumstances.

It is worthwhile to point out that much of the blame for the nation's current housing problems can be traced to a category of ARM loans that are referred to as "Sub-Prime" loans. Because these loans commonly adjust in as little as two or three years, you can see how important it might have been to know and understand what the "Margin" was on this type of loan. Sadly, the margin was a factor that was not discussed or received little attention. Knowing that the margins typically ranged from 4%-7% quickly explains why so many of these borrowers now find themselves unable to make their mortgage payments. If there is any silver lining that might reduce the seriousness of this situation, it is the fact that the indices for these loans (Treasury or Libor Index) have fallen significantly, because of the Fed's move to decrease short-term rates.