Home Mortgage and Interest Rates

When you purchase a home for the first time, one of the most important things you will have to figure out is whether a fixed rate or adjustable rate mortgage (ARM) is best for you. First, of course, you need a clear idea of what they are.

Fixed Rate Home Mortgage

To put it simply, the interest rate of a fixed rate home mortgage is unchanging. This rate is frozen for the term of the loan, meaning that your rate will stay the same no matter what happens to interest rates over the term of the loan. Oftentimes, new buyers decide to use a fixed rate home mortgage, as this kind of loan is easier to plan for in the long term. Because the interest rate on your home mortgage never changes, neither do your payments. For example, if you take on a $175,000 home mortgage with a fixed rate of 6.5% for 30 years, your payments will be $1106 throughout the length of the fixed rate loan (without escrow costs).

There are pros and cons to singing up for a fixed rate home mortgage. While you will always be able to depend on a fixed mortgage payment (excluding property tax and insurance), you will typically have a higher interest rate than if you used an ARM. The reason for the higher rates is that the banks typically take a greater risk on fixed rate mortgages and therefore can charge a premium to lock in a rate for the entire term of the mortgage.

Adjustable Rate Home Mortgage

An adjustable rate home mortgage is often called a floating rate, as your rate changes along with interest rate indexes. Normally, this kind of home mortgage will start off with a fixed rate for a predetermined amount of time (generally three to ten years). After that time, the rate will adjust at predetermined intervals. At these adjustment periods the rate you pay will rise and fall along with whatever index your rate is tied to. Simply put, if rates go up, your home mortgage payments will go up as well.

Normally, an adjustable home mortgage rate will start off lower than a comparable fixed rate for a 30 year mortgage. But if rates go up across the board, your interest rates will rise. To reduce some of that risk, many ARMs come with a rate cap, allowing your rates rise only a specified number of percentage points.

The key to choosing the right loan for you is knowing how long you will be in your home and understanding your tolerance for risk. If you will only be in your home for a few years, you could save money by taking advantage of an adjustable rate mortgage that has a low fixed introductory rate for 3 to 5 years. Chances are, you will have left the house before your rates ever change. If you plan to be in your home longer and dont want to face a rate adjustment, the longer term fixed rate option may be the best fit for you.   Related Articles Home equity loan | Refinance | Loans |

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