NEWS FROM SCDCA

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FOR IMMEDIATE RELEASE

PART ONE: SCDCA ALERTS CONSUMERS ABOUT POTENTIAL RISKS OF ADJUSTBALE RATE MORTGAGES

Columbia, SC… … …Shopping for a mortgage used to be a relatively simple process. Most home mortgage loans had interest rates that did not change over the life of the loan. Choosing among these fixed-rate mortgage (FRM) loans meant comparing interest rates, monthly payments, fees, prepayment penalties, and due-on-sale clauses.

Today, many loans have interest rates (and monthly payments) that can change from time to time. To compare a **fixed-rate mortgage** with an **adjustable rate mortgage (ARM)**, you need to know about indexes, margins, discounts, caps, negative amortization, and convertibility. You need to consider the maximum amount your monthly payment could increase. Most important, you need to compare what might happen to your mortgage costs with your future ability to pay.

"Is an ARM the right type of loan for you?" That depends on your financial situation and the terms of the ARM. You will be able to answer the question better once you understand more about ARMs. This two-part series should help. Mortgages have changed, and so have the questions that consumers need to ask and have answered.

What is an ARM?

With a fixed-rate mortgage, the interest rate stays the same during the life of the loan. But with an ARM, the interest rate changes periodically, usually in relation to an index. Payments may go up or down accordingly. Lenders generally offer lower initial interest rates for ARMs than for fixed-rate mortgages. This makes the ARM easier on your pocketbook at first than a fixed-rate mortgage. Additionally, you might qualify for a larger loan because lenders sometimes determine whether to extend a loan based on your current income and the first year's payments. Moreover, your ARM could be less expensive over a long period than a fixed-rate mortgage if, for example, interest rates remain steady or move lower. Despite these advantages, you must consider the risk of interest rate increases that would cause higher monthly payments in the future. ARMs offer a trade-off: lower rates for more risks. You should also ask yourself these questions about ARMs:

- Is my expected income likely to cover higher mortgage payments if interest rates go up?
- Will I be taking on other sizable debts, such as loans for a car or school tuition, in the near future?
- How long do I plan to own this home? (If you plan to sell soon, rising interest rates may not pose the problems they would if you plan to own the house for a long time.)
- Can my payments increase even if interest rates generally do not increase?

HOW ARMS WORK: THE BASIC FEATURES

The Adjustment Period With most ARMs, the interest rate and monthly payment change every year, every three years, or every five years. However, some ARMs have more frequent rate and payment changes. The period between one rate change and the next is called the "adjustment period." A loan with an adjustment period of one year is called a one-year ARM, and the interest rate can change once every year.

The Index Most lenders tie ARM interest-rate changes to changes in an "index rate." These indexes usually correspond with the general movement of interest rates. Similarly, your mortgage rate usually moves up and down with the index rate. An increase in the index rate is likely to result in higher monthly payments. A decrease in the index rate, however, is likely to result in lower payments.

The Margin To determine the total interest rate on an ARM, lenders add a few percentage points to the index rate called the "margin." The amount of the margin may differ from one lender to another, but it is usually constant over the life of the loan.

Further information about ARMs will be provided next week in Part Two of this series. Part Two will address specific features of ARMs that consumers must approach with heightened caution.