

Choosing a Mortgage: Adjustable or Fixed Rate – Which is Better for You?

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You've made the decision to purchase a home. Now what? Purchasing a home is one of the largest decisions that you will make in your lifetime. It can be a rewarding experience, but it can also be one of your most stressful events. Much thought and research, on your part, must go into the process; from selecting the right home in the right location, to obtaining financing. Before you begin looking at homes, it's a very good idea to visit a lender to determine which type of mortgage is best for you. Pre-qualification is the first step in the mortgage process.

Pre-Qualification

A lender will analyze your current income, debt and credit history in order to qualify you for a maximum mortgage amount that you can adequately manage. Knowing this figure may save you time and disappointment when you begin your home search. One of the most important factors in the pre-qualification process is what type of mortgage you qualify for, and which mortgage is best for you. There are two types of mortgages; fixed rate and adjustable rate.

Fixed

A fixed rate mortgage offers a fixed term (for example 15 or 30 years) as well as a fixed rate of interest from the start of the mortgage. The monthly payment of principal and interest will not change during the life of the loan making it possible for the homeowner to budget more easily. To compensate the bank for the risk associated with a long-term loan, the rate offered on a fixed rate mortgage is typically a bit higher than offered on an adjustable rate product.

Adjustable

The term on an adjustable rate mortgage or (ARM) does not change, but the rate of interest will change since the loan "adjusts" at predetermined intervals. Because there is less interest rate risk to the bank associated with an adjustable rate mortgage, they will typically start at a lower interest rate than a fixed mortgage, making your initial monthly principal and interest payments lower. Does it make sense to take out an adjustable rate mortgage? The answer may be yes, depending on how you answer the following questions:

Based on my future income, will I be able to afford higher mortgage payments if the rates go up?
When comparing products, do I think that rates will remain the same, increase or decline in the future?
How long do I plan to stay in this house and which mortgage is a better investment for me?

There are trade-offs and risks involved with an adjustable rate mortgage. Deciding if the risks are worth it is a personal decision that must be made by every homeowner. Knowing these facts and being able to answer the questions above will help you to make the right decision. Your lender will also be able to help you by providing their expertise in presenting all of the options that are available.

Do your homework

The key to selecting the right mortgage is to find the loan that best fits your personal budget and situation, rather than trying, or worse yet, hoping that your budget and situation magically conform to your mortgage. In addition to monthly principal and interest payments, your lender may require you to pay real estate taxes (escrow) and Private Mortgage Insurance (PMI). Knowing these figures will help you determine if you can comfortably afford your new home purchase. Another good test to determine if you are ready to buy the home you have selected is to calculate the difference between your current rent or mortgage payment and the proposed new payment to determine if the new payment is within your means.

The road to financial ruin is littered with examples of homebuyers who did not do the research necessary to ensure that they selected the right mortgage. Don't let this happen to you. Take your time, do your research and safely navigate your way to homeownership by selecting the right mortgage.