

Adjustable rate mortgages offer savings as well as risk

BY SCOTT CUMMINGS

There have never been more choices for financing a home than there are today. There are literally hundreds, if not thousands, of different mortgage financing options for someone to consider when obtaining a mortgage loan. How can a consumer determine which financing program meets his needs?

For many consumers the primary consideration when obtaining mortgage financing is the affordability of the monthly payment. With the significant increases in property values over the past five years affordability has become a major concern for many families.

Adjustable rate mortgages (ARMs) can provide a 20 percent to 50 percent reduction in the monthly mortgage payment due to the "below market" interest rates offered initially. However, as interest rates increase, a monthly mortgage payment can increase by up to 20 percent per year. Since most consumers do not monitor or follow the economic indices used to determine their interest rates, they are shocked when they are notified of upcoming interest rate and payment increases.

This can have a dramatic impact on a family's ability to continue to make its mortgage payment and meet its monthly obligations. Unfortunately, many consumers have not set aside or invested any additional funds to budget for these increases and might not be able to afford the payment increases. Thus, without proper planning, they are putting their finances, and ultimately, their homes at risk.

The most significant factor when considering an ARM is an understanding that interest rates are cyclical and are impacted by economic news just like the stock market. Therefore, a consumer can experience huge swings in the interest rates and monthly payments based on the economy and the Federal Reserve's interest rate policies. The current Fed tightening policy has substantially raised the short-term ARM indices and rates on adjustable rate mortgages. Consumers need to understand that ARM's are not for everyone due to the inherent interest rate and payment fluctuations.

Home Equity Lines of Credit are another type of an adjustable rate mortgage. Due to the substantial appreciation of home values in America, millions of consumers have used home equity loans to access their home equity for a variety of reasons. Unfortunately, home equity loan rates have increased 17 times since June of 2004 as a result of the Federal Reserve repeatedly raising the Fed Funds rate. The 17 rate increases by the Federal Reserve has almost doubled the required minimum interest-only payments on a home equity loans. Home equity loans are tied to the Prime Rate which is currently at 8.25 percent. Today, the average home equity interest rate is 1 percent over the Prime Rate at 9.25 percent.

Adjustable rate mortgages, if used properly, can provide significant savings and flexibility for families that manage their money and finances accordingly. Adjustable rate mortgages can and do provide an excellent way to minimize the monthly payments on a mortgage loan. Many times

they allow consumers to buy a larger home for the same payment, consolidate debt or provide themselves with greater payment flexibility. However, consumers must be committed to managing or investing the savings to build liquidity, safety and peace of mind.

What is the key difference between creating a huge financial risk or real savings for a consumer? It all starts with an understanding and an education on how to integrate your mortgage into your overall financial goals and objectives. Consumers need to manage their mortgage and home equity like they manage their other investments. This means that consumers might need to adjust their mortgage financing during their home ownership based on the cyclical nature of our economy and interest rates, just like they might need to diversify their investments based on shifts within the financial markets. By taking a more active approach in managing their mortgage, consumers can minimize their monthly payments, pay off their mortgages faster, maximize their tax savings and use the improved cash flow to fund investments, college tuition, retirement and/or other financial needs.

Typically, our home is our largest asset and the mortgage is the largest debt. Therefore, how people handle their investments in their homes and their mortgage financing has far reaching implications into every area of their personal finances and their ability to achieve financial independence.

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