Home Mortgage and Interest Rates

When buying your home, one of the first big decisions youll have to make is whether to go for a fixed rate or an adjustable rate mortgage (ARM). Before knowing which is best for you, however, you need to be aware of how each one works.

Fixed Rate Home Mortgage

A fixed rate mortgage has an interest rate that does not change. 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. This means that if you purchase a home for $175,000 at rate of 6.5% for 30 years, your monthly home mortgage payments will stay at $1106 (excluding any escrow costs), and never deviate during the course of the term.

There are upsides and downsides to going with a fixed rated home mortgage. Though you will always be able to predict your monthly home mortgage payments (except for any property taxes and homeowners insurance), your interest rates will generally be higher than with an adjustable rate mortgage. This is because banks are generally taking on more risk with fixed rate loans, and so charge you more for keeping a frozen rate for the duration of your home mortgage.

A Home Mortgage with Adjustable Rate Interest

An adjustable rate home mortgage is often called a floating rate, as your rate changes along with interest rate indexes. Typically, adjustable rate mortgages begin with a short period in which the rate is fixed (usually 3 to 10 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. To put it simply: if interest rates go down, your payment will go down also.

Normally, an adjustable home mortgage rate will start off lower than a comparable fixed rate for a 30 year mortgage. But if interest rates go up, your payments will go up. 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 most important part of deciding on the best loan for you is having a thorough understanding of your acceptance of risk, as well as a plan for the amount of time you will own the home. 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. Youll be out of the house before the rate ever adjusts. 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. More articles | More articles | More articles | More articles | More articles |

About the Author

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