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# Mind your ARMs

**Is it time to give up your low adjustable-rate mortgage for a fixed-rate loan?**

**By Amy Hoak, MarketWatch**

**CHICAGO (MarketWatch) -- Low mortgage rates over the past year have inspired many Americans to refinance their home loans, but some eligible borrowers haven't made the leap.**

Often that reluctance to refinance stems from the fact that interest rates on their adjustable-rate mortgages have fallen below 3% -- a better rate than they'd get by switching to a fixed-rate loan.

For now, anyway.

As the economy strengthens, super-low ARM rates will adjust upward. Meanwhile, rates on fixed-rate mortgages are expected by many in the industry to start rising this year, after the Federal Reserve halts its purchase of mortgage-backed securities.

**When the Fed exits mortgage market**

The central bank is helping to keep rates low and fund loans for home buyers and refinancers, but in March it plans to end its support. Greg McBride at Bankrate.com says buyers still have some time, but if you're eager to refinance, get going. MarketWatch's Andrea Coombes reports.

Many ARM holders are faced with two options: Give up their low rate now and refinance into a fixed-rate mortgage with a higher rate -- but one that's still near all-time lows, or hold on to that cheaper ARM rate as long as possible.

If your rate is indexed to the Libor, it could be at about 3% right now, said Keith Gumbinger, vice president for HSH Associates, publisher of consumer loan information. The 30-year fixed-rate mortgage averaged 4.93% for the week ending Feb. 18, assuming payment of an average 0.7 point to obtain it, according to the latest Freddie Mac survey of conforming mortgage rates. See Mortgages.

"Some borrowers may opt to roll the dice again," Gumbinger said, and decide to stay in their current ARM to enjoy the lower rates as long as they can.

Trying to time the market, though, can be risky.

"The market can change very fast," said Jack Guttentag, professor of finance emeritus at the Wharton School of the University of Pennsylvania, and operator of "The Mortgage Professor" Web site, at mtgprofessor.com.

Depending on market conditions, it's not impossible for an ARM's rate to jump at least a couple of percentage points when it resets, he said.

"If you're an ARM borrower, you can't just look at your ARM rate and wait for that to change," he added. If you do, you could be headed for some payment shock -- and possibly miss out on securing a low fixed-rate mortgage that will remain low throughout the entire life of the loan.

**Pick your moment**

ARMs typically reset after an introductory fixed-rate period, then reset regularly, often on an annual basis. For example, a typical 5/1 ARM will adjust for the first time five years into the loan, then will reset every year afterwards. There are often caps on how high the rate can adjust.

If the difference between someone's current ARM rate and the fixed-rate they'd be able to obtain isn't too large -- say, 1% or less -- there likely isn't a significant difference in monthly payment and it might be wise to refinance now, even if it means forfeiting your current low rate, Guttentag said. That way, you can secure a low fixed rate now and not gamble on when rates will move higher.

But for those with an ARM rate of 3% or less, it's a tougher decision.

Those who don't err on the side of caution and choose not to refinance now should vow to be astutely aware of the market so they can refinance before rates go up substantially, Guttentag said. They need to pay special attention to the index to which their ARM is tied -- the 1-year Treasury or the Libor, for example.

"If someone decided to do watchful waiting, they should establish a rule for themselves. Something like 'if that index increases by more than 1 or 1.5%, I'm going to move, I'm going to refinance,'" he said. "If you're not prepared to exercise this surveillance, you should refinance right now and trade short-term loss for long-term stability."

He also recommends developing a refinance strategy, getting your information ready for when it's time to make a move.

When will that be? It's difficult to tell. The consensus is that mortgage rates will go up, but no one knows exactly when or by how much.

"Rates are not going to go down this year. The question is: How much are they going to go up," said Mark Goldstein, chief executive of Refinance.com, a site that helps people decide whether to refinance and puts them in touch with lenders.

The Mortgage Bankers Association is predicting that average rates on 30-year fixed-rate mortgages will rise to about 6.1% by the end of the year, said Michael Fratantoni, vice president of research for the MBA. HSH Associates predicts the increase won't be quite as severe.

**A shrinking pool**

Not all homeowners who haven't refinanced are ARM holders. Some simply can't refinance into a lower rate.

"For a lot of borrowers, they had the incentives before and didn't act -- largely because they don't have equity or don't qualify for income or credit reasons," Fratantoni said. For this reason, the MBA predicts a 65% drop in refinance origination this year, compared with 2009.

Probably the biggest reason people aren't able to refinance right now is because their mortgage is underwater -- that is, the homeowner owes more on the home than the home is currently worth, Goldstein said. Personal situations, such as divorce, also can alter people's creditworthiness and keep them from refinancing into a lower-cost loan, he said.

Some struggling borrowers might find relief in the government's Home Affordable Refinance Program, set to expire in June. And if conditions do improve -- meaning home prices stabilize and lending requirements ease somewhat -- the pool of people who can refinance could expand, Gumbinger said. Visit this site to find out more about the government's Home Affordable Refinance Program.