



Adjustable Rate Mortgages – How the Index & Cap Can Affect Your Deal

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An adjustable rate mortgage (ARM) can be a valuable tool for real estate investors seeking lower monthly payments and higher cash flow. But buyer beware. It's important to know the **index** to which your

adjustable rate is tied, the **margin**, the **adjustment period**, and the **cap** so that you fully understand your loan.

Index. The three most commonly used ARMs indexes include:

- **LIBOR, the London Interbank Offered Rate.** A standard financial index used in U.S. capital markets, this is the interest rate at which banks offer to lend money among themselves within London's wholesale money markets. LIBOR changes tend to be smaller than prime rate changes.
- **MTA, a 12-month Moving Treasury Average.** An index determined by the monthly average of one-year Treasury bills.
- **11th District COFI, a monthly cost-of-index.** An index that reflects the weighted-average interest rate paid by 11th Federal Home Loan Bank District savings institutions for savings and checking accounts. It's published at the end of each month to reflect the cost of funds for the prior month.

Margin. The margin is a percentage the lender adds to the base index rate. It accounts for the lender's cost of doing business and any profit the lender will make on the loan.

Adjustment Period. ARMs are often described in terms of their adjustment period, which is the period between potential interest rate adjustments. Typically these are 1-year, 3-year or 5-year.

Cap. The cap reflects how high the ARM interest rate can climb during a specific time period, which is typically defined as six months, a year, or the life of the loan.

Understanding how your ARM rate will be determined and how high it could potentially go is critical for real estate investors. It could spell the difference between a great deal and an unpleasant payment surprise.



Got questions about real estate financing?

Contact Debbie@westchester-mortgage.com or 617-965-1236. She'll consider them for inclusion in a future column. Debbie Siegel is president of Westchester Mortgage in Newton, Massachusetts. She is licensed in several Northeastern states.