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Are Variable Rate Mortgages a Ticking Time Bomb?

Mortgages can come in various forms, one of which involves the fact that the interest rate does not come predetermined for the entire lifetime of the loan. These loans are called Variable rate (or adjustable rate) mortgages. The upside to these loans revolves around the ability for people who could not generally afford a mortgage to be able to get a mortgage with low interest rates. The downside comes from the fact that the mortgage rates could drastically increase over time. Especially in today's mortgage market Variable Rate Mortgages could lead to disaster.

What Is a Variable Rate Mortgage?

Simply put a Variable Rate Mortgage has a changing rate. The rate is not locked in at the signing of the contract; rather it changes with the economy. The mortgage payments can change based on the interest rate. In recent years these loans have been good because the overall interest rates have been low and they are a good way for people to pay for a more expensive home.

The downfall of these mortgages can come from the fact that the mortgage rate can increase to an amount that puts too much of a strain on most people's monthly budgets, forcing them to default on their loans, thusly ruining their credit.

Is this a Bomb Waiting to Go Off?

Because the cycle of interest rates usually follows a pattern of being high then going to low, then going back to high, many people look at the situation of ARMs being a negative one. They see the current mortgage rates to be low so they assume they will go higher. Others look at the current ARMs and see that they are generally lower than fixed rates and say that in the long run money will be saved even if rates do increase.

For the people who depend on the low rates, ARMs can be very dangerous. The low rates of 2006 and 2007 will not last forever and the amount of money they have saved will not last long as their rates increase. So in that sense these loans can be very dangerous.

What Should You Do?

Refinancing might be one of the best options you could choose at the moment due to the forecasts for interest rates to increase following the sub prime mortgage fallout. The rates are still relatively low and the lock in security of a fixed loan at these rates could outweigh the potential threat of defaulting on a loan.

If you're currently looking to buy a house and are considering mortgage options, the slightly higher rate of a fixed rate mortgage will prove to be a better choice in the long run due to the predicted increase in rates and depression in the economy. There will be no surprise increase in payments leading to the loss of your home because you had to default on your loan.