CONSUMER HANDBOOK ON

Adjustable-Rate Mortgages

Find out how your payment can change over time

cfpb Consumer Financial Protection Bureau

An official publication of the U.S. government

How to use the booklet

When you and your mortgage lender discuss adjustable-rate mortgages (ARMs), you receive a copy of this booklet. When you apply for an ARM loan, you receive a Loan Estimate. You can request and receive multiple Loan Estimates from competing lenders to find your best deal.

You may want to have your Loan Estimate handy for any loan you are considering as you work through this booklet. We reference a sample Loan Estimate throughout the booklet to help you apply the information to your situation.

You can find more information about ARMs at **cfpb.gov/about-arms**. You'll also find other mortgage-related CFPB resources, facts, and tools to help you take control of the homebuying process.

About the CFPB

The Consumer Financial Protection Bureau regulates the offering and provision of consumer financial products and services under the federal consumer financial laws and educates and empowers consumers to make better informed financial decisions.

This booklet, titled Consumer Handbook on Adjustable Rate Mortgages, was created to comply with federal law pursuant to 12 U.S.C. 2604 and 12 CFR 1026.19(b)(1).

How can this booklet help you?

This booklet can help you decide whether an adjustable-rate mortgage (ARM) is the right choice for you and to help you take control of the homebuying process.

Your lender may have already provided you with a copy of Your Home Loan Toolkit. You can also download the Toolkit from the CFPB's Buying a House guide at **cfpb.gov/buy-a-house/**.

An ARM is a mortgage with an interest rate that changes, or "adjusts," throughout the loan.

With an ARM, the interest rate and monthly payment may start out low. However, both the rate and the payment can increase very quickly.

Consider an ARM only if you can afford increases in your monthly payment—even to the maximum amount.

After you finish this booklet:

- You'll understand how an ARM works and whether it's the right choice for you. (page 2)
- You'll know how to review important documents when you apply for an ARM. (page 6)
- You'll understand the risks that come with different types of ARMs. (page 18)

Is an ARM right for you?

ARMs come with the risk of higher payments in the future that you might not be able to predict. But in some situations, an ARM might make sense for you. If you are considering an ARM, be sure to understand the tradeoffs.

TIP

Don't count on being able to refinance before your interest rate and monthly payments increase. You might not qualify for refinancing if the value of your home goes down or if something unexpected damages your financial situation, like a job loss or medical costs.

COMPARE	FIXED-RATE MORTGAGE	ADJUSTABLE-RATE MORTGAGE
Consider this option if	• You prefer predictable payments, or • You plan to keep your home for a long period of time	• You are confident you can afford increases in your monthly payment—even to the maximum amount, or • You plan to sell your home within a short period of time
Interest rate	• Set when you take out the loan • Stays the same for the entire loan term	• Based on an index that changes • May start out lower than a fixed rate mortgage but you bear the risk of increases throughout your loan
Monthly payment	• Principal and interest payment stays the same over the life of your loan • You know the total you will pay in principal and interest over the life of the loan	• Initial principal and interest payment amount remains in effect for a limited period • You can't know in advance how much total interest you will pay because your interest rate changes • If you can't afford the increased payments, you may lose your home to foreclosure

Learn about how ARMs work

As you decide whether to move ahead with an ARM, you should understand how they work and how your housing costs can be affected.

Interest rate = index + margin

The interest rate on an ARM has two parts: the index and the margin.

INDEX

An **index** is a measure of interest rates generally that reflects trends in the overall economy. Different lenders use different indexes for their ARM programs.

Common indexes include the U.S. prime rate and the Constant Maturity Treasury (CMT) rate. Talk with your lender to find out more about the index they use, which is also shown on your Loan Estimate.

MARGIN

The **margin** is an extra percentage that the lender adds to the index.

You can shop around to different lenders to find the lowest combination of the index plus the margin. Your Loan Estimate shows the index and the margin being offered to you.

Changes to initial rate and payment

The *initial* interest rate and *initial* principal and interest payment amount on an ARM remain in effect for a limited period.

So, when you see ARMs advertised as 5/1 or 5/6m ARMs:

- The first number tells you the length of time your initial interest rate lasts.
- The second number tells you how often the rate changes after that.

For example, during the first five years in a 5/6m ARM your rate stays the same. After that, the rate may adjust every six months (the 6m in the 5/6m example) until the loan is paid off. This period between rate changes is called the **adjustment period**. Adjustment periods can vary. Some last a month, a year, or like this example, six months.

For some ARMs, the initial rate and payment can be very different from the rates and payments later in the loan term. Even if the market for interest rates is stable, your rates and payments could change a lot.

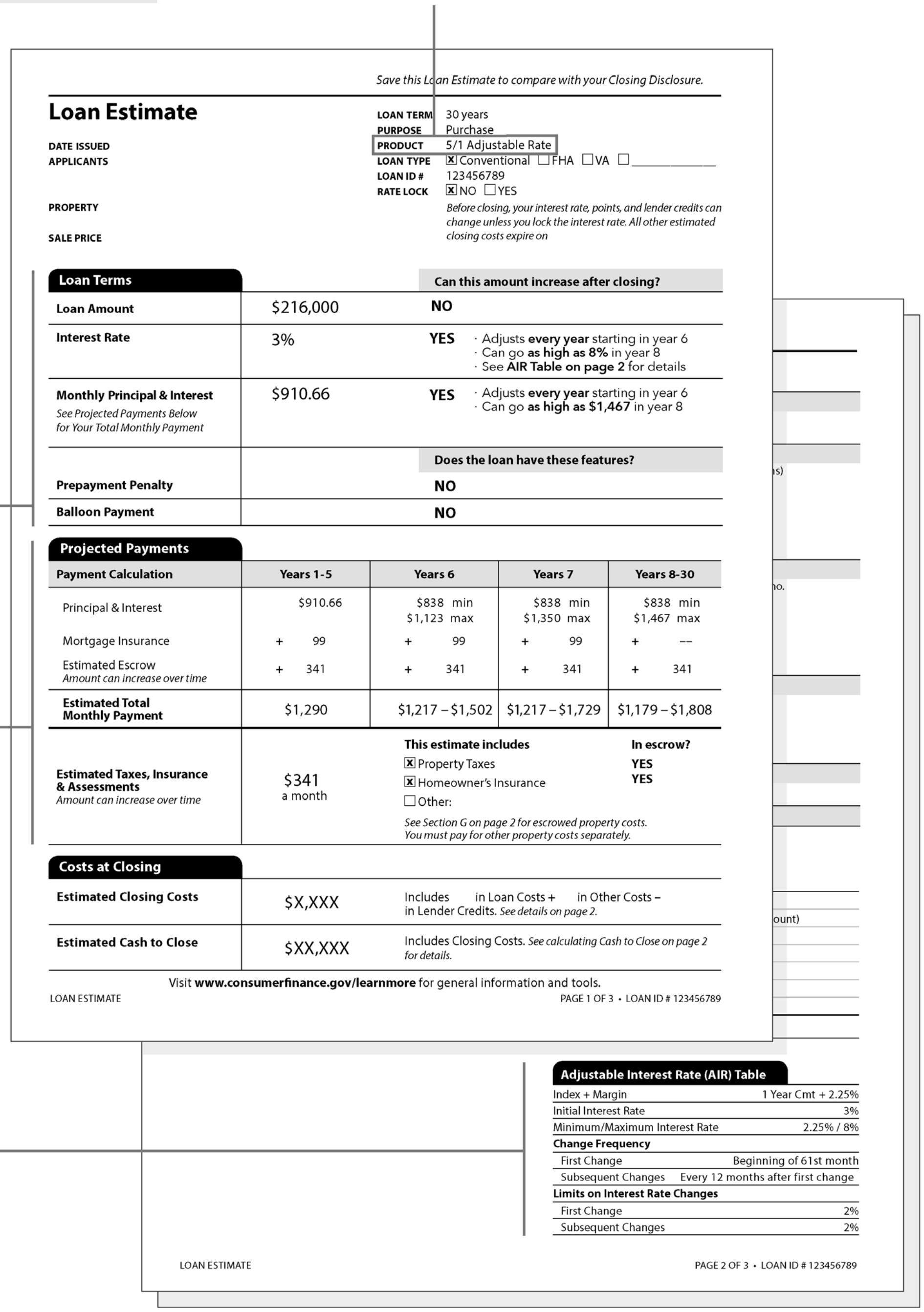
Use your Loan Estimate to understand your ARM

When you apply for a mortgage, the lender gives you a document called a **Loan Estimate.** It describes important features of the loan the lender is offering you. This section illustrates the parts of a Loan Estimate that are specific features of ARM loans. An interactive, online version of a Loan Estimate sample is available at: **cfpb.gov/arm-explainer/**

Loan Terms

Projected Payments

Adjustable Interest Rate (AIR) Table



Save this Loan Estimate to compare with your Closing Disclosure.

Loan Estimate

DATE ISSUED
APPLICANTS

PROPERTY
SALE PRICE

LOAN TERM 30 years
PURPOSE Purchase
PRODUCT 5/1 Adjustable Rate
LOAN TYPE ☒ Conventional ☐ FHA ☐ VA ☐ ____________
LOAN ID # 123456789
RATE LOCK ☒ NO ☐ YES

Before closing, your interest rate, points, and lender credits can change unless you lock the interest rate. All other estimated closing costs expire on

Loan Terms		Can this amount increase after closing?
Loan Amount	$216,000	NO
Interest Rate	3%	YES · Adjusts **every year** starting in year 6 · Can go **as high as 8%** in year 8 · See **AIR Table on page 2** for details
Monthly Principal & Interest *See Projected Payments Below for Your Total Monthly Payment*	$910.66	YES · Adjusts **every year** starting in year 6 · Can go **as high as $1,467** in year 8
		Does the loan have these features?
Prepayment Penalty		NO
Balloon Payment		NO

Projected Payments				
Payment Calculation	Years 1-5	Years 6	Years 7	Years 8-30
Principal & Interest	$910.66	$838 min $1,123 max	$838 min $1,350 max	$838 min $1,467 max
Mortgage Insurance	+ 99	+ 99	+ 99	+ ––
Estimated Escrow *Amount can increase over time*	+ 341	+ 341	+ 341	+ 341
Estimated Total Monthly Payment	$1,290	$1,217 – $1,502	$1,217 – $1,729	$1,179 – $1,808

Estimated Taxes, Insurance & Assessments *Amount can increase over time*	$341 a month	This estimate includes ☒ Property Taxes ☒ Homeowner's Insurance ☐ Other: *See Section G on page 2 for escrowed property costs. You must pay for other property costs separately.*	In escrow? YES YES

Costs at Closing		
Estimated Closing Costs	$X,XXX	Includes in Loan Costs + in Other Costs – in Lender Credits. *See details on page 2.*
Estimated Cash to Close	$XX,XXX	Includes Closing Costs. *See calculating Cash to Close on page 2 for details.*

Visit **www.consumerfinance.gov/learnmore** for general information and tools.

LOAN ESTIMATE PAGE 1 OF 3 • LOAN ID # 123456789

Adjustable Interest Rate (AIR) Table	
Index + Margin	1 Year Cmt + 2.25%
Initial Interest Rate	3%
Minimum/Maximum Interest Rate	2.25% / 8%
Change Frequency	
First Change	Beginning of 61st month
Subsequent Changes	Every 12 months after first change
Limits on Interest Rate Changes	
First Change	2%
Subsequent Changes	2%

LOAN ESTIMATE PAGE 2 OF 3 • LOAN ID # 123456789

Loan terms

INTEREST RATE

The Loan Estimate shows the *initial* interest rate you pay at the beginning of your loan term. This row also shows how often your rate can change and how high it can go.

MONTHLY PRINCIPAL & INTEREST

The Loan Estimate shows the *initial* monthly principal and interest payment you'll make if you accept this loan. Your **principal** is the money that you originally agreed to pay back on your loan. **Interest** is a cost you pay to borrow the principal. The initial principal and interest payment amount for an ARM is set only for the initial period and may change after that.

THE TALK

You might hear, "An ARM makes sense because you can refinance the loan before your interest rate and monthly payment increase."

Ask yourself, a spouse, or a loved one:

"What if the market value of the home goes down?"

"What if our financial situation or our credit score gets damaged by something unexpected like a job loss or illness?"

"If we can't refinance at a better rate, can we afford the maximum interest rate and payment increase under this loan?"

Loan Terms		Can this amount increase after closing?
Loan Amount	$216,000	**NO**
Interest Rate	3%	**YES** · Adjusts **every year** starting in year 6 · Can go **as high as 8%** in year 8 · See **AIR Table** for details
Monthly Principal & Interest *See Projected Payments Below for Your Total Monthly Payment*	$910.66	**YES** · Adjusts **every year** starting in year 6 · Can go **as high as $1,467** in year 8
		Does the loan have these features?
Prepayment Penalty		**NO**
Balloon Payment		**NO**

Example of "Loan terms" section. Find this on page 1 of your own Loan Estimate

Projected Payments				
Payment Calculation	**Years 1-5**	**Years 6**	**Years 7**	**Years 8-30**
Principal & Interest	$910.66	$838 min $1,123 max	$838 min $1,350 max	$838 min $1,467 max
Mortgage Insurance	+ 99	+ 99	+ 99	+ ––
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Example of "Projected payments" section. Find this on page 1 of your own Loan Estimate

Projected payments

PRINCIPAL & INTEREST

The monthly principal and interest payment on your ARM is likely to change after the initial period. Review this section to see how your payment can change based on your loan's interest rate.

ESTIMATED TOTAL MONTHLY PAYMENT

Review this row to see the total minimum and maximum monthly payments. The payments include mortgage insurance, property taxes, homeowners insurance, and any additional property assessments or other escrow items. Learn more about these mortgage terms at **cfpb.gov/mortgage-terms/**

Keep in mind that other parts of your monthly and annual housing costs can change, such as your property taxes and homeowners insurance payments.

THE TALK

Talk over how your financial life could be affected if your ARM monthly payment increases. In future years, you might face money decisions like:

- **Job changes**
- **School or other education expenses**
- **Medical needs and expenses**

Because ARM adjustments are unpredictable, you might have less or more financial flexibility for other parts of your life.

Adjustable Interest Rate (AIR) table

You should read and understand the AIR table calculations before committing to an ARM. It's important to know how your interest rate changes over the life of your loan.

INDEX + MARGIN

Your lender is required to show you how your interest rate is calculated, which is determined by the index and margin on your loan. See page 2 of this booklet for more about index and margin.

INITIAL INTEREST RATE

This is the interest rate at the beginning of your loan. The initial interest rate changes to the index plus the margin at your first adjustment (subject to the limits on interest rate changes). Your loan servicer tells you your new payment amount seven to eight months in advance, so you can budget for it or shop for a new loan.

MINIMUM / MAXIMUM INTEREST RATE

This shows how low or high your interest rate could be over the life of your loan. Generally, an ARM's interest rate is never lower than the margin.

CHANGE FREQUENCY

This indicates when the interest rate on your loan will change. Your loan servicer sends you advance notices of changes.

LIMITS ON INTEREST RATE CHANGES

This shows the highest amount your interest rate can increase when there is a change.

Adjustable Interest Rate (AIR) Table	
Index + Margin	1 Year Cmt + 2.5%
Initial Interest Rate	3%
Minimum/Maximum Interest Rate	2.5% / 8%
Change Frequency	
First Change	Beginning of 61st month
Subsequent Changes	Every 12 months after first change
Limits on Interest Rate Changes	
First Change	2%
Subsequent Changes	2%

Example of "AIR table" section. Find this on page 2 of your own Loan Estimate

"TEASER" RATES

Some lenders offer a "teaser," "start," or "discounted" rate that is lower than their fully indexed rate. When the teaser rate ends, your loan takes on the fully indexed rate. Don't assume that a loan with a teaser rate is a good one for you. Not everyone's budget can accommodate a higher payment.

Consider this example:

- **A lender's fully indexed rate is 4.5% (the index is 2% and the margin is 2.5%).**
- **The loan also features a "teaser" rate of 3%.**
- **Even if the index doesn't change, your interest rate still increases from 3% to 4.5% when your teaser rate expires.**

COMPARE YOUR ARM OFFERS

Shop for at least three loan offers, and fill in the blanks below using the information on your Loan Estimates:

	ARM OFFER 1	ARM OFFER 2	FIXED-RATE OFFER
Lender name			
Loan amount	$	$	$
Initial interest rate	%	%	%
Initial principal and interest payment	$	$	$
Index			
Margin			
How long will the initial interest rate and initial payment apply?			
How high can my interest rate go?	%	%	%
How high can my principal and interest payment go?	$	$	$

My best loan offer is: ____________________

THE TALK

You are in control of whether or not to proceed with an ARM. If you prefer to proceed with a fixed-rate mortgage, here is one way to start the conversation with a lender:

"A fixed-rate mortgage seems to be a better fit for me. Let's talk about what you can offer and how it compares to other loans I may be able to get."

Review your lender's ARM program disclosure

Your lender gives you an ARM program disclosure when they give you an application. This is the lender's opportunity to tell you about their different ARM loans and how the loans work. The index and margin can differ from one lender to another, so it is helpful to compare offers from different lenders.

Generally, the index your lender uses won't change after you get your loan, but your loan contract may allow the lender to switch to a different index in some situations.

GATHER FACTS

Review your program disclosure and ask your lender questions to understand their ARM loan offerings:

- ☐ How are the interest rate and payment determined?
- ☐ Does this loan have interest-rate **caps** (that is, limits on interest rate changes)?
- ☐ How often do the interest rate and payment adjust?
- ☐ What index is used and where is it published?
- ☐ Is the initial interest rate lower than the fully indexed rate? (see "Teaser rates," on page 12)
- ☐ What type of information is provided in notices of adjustment and when do I receive them?

Ask about other options offered by your lender

Conversion option

Your loan agreement may include a clause that lets you convert the ARM to a fixed-rate mortgage in the future.

When you convert, the new rate is generally set using a formula given in your loan documents. That fixed rate may be higher or lower than interest rates available to you in the market at that time. Also your lender may charge you a conversion fee. Ask your lender whether the loan you are being offered has a conversion feature and how it works.

Special features

You can shop around to understand what special ARM features may be available from different lenders.

Not all programs are the same. Talk with your lender to find out if there's anything special about their ARM programs that you may find valuable.

Check your ARM for features that could pose risks

Some types of ARMs have features that can reduce your payments in the short term but may include fees or the risk of higher payments later. Review your loan terms and make sure that you understand the fees and how your rate and payment may change. **Lower payments at the beginning could mean higher fees or much higher payments later.**

Paying points to reduce your initial interest rate

Lenders can offer you a lower rate in exchange for paying loan fees at closing, or **points**.

With an ARM, paying points often reduces your interest rate only until the end of the initial period—the reduction most likely does not apply over the life of your loan.

If you are using an ARM to refinance a loan, points are often rolled into your new loan amount. You might not realize you are paying points unless you look carefully. Points are disclosed on the top of Page 2 of your Loan Estimate.

Lenders may give you the option to pay points, but you never have to take that option. To figure out if you have a good deal, compare your cost in points with the amount that you will save with a lower interest rate.

Loan Costs	
A. Origination Charges	**$3,160**
1% of Loan Amount (Points)	$2,160
Application Fee	$500
Processing Fee	$500

Example of "Loan costs" section. Find this on page 2 of your own Loan Estimate

THE TALK

If your Loan Estimate shows points, ask your lender:

- **"What is my interest rate if I choose not to pay points?"**
- **"How much money do I pay in points? And, compared to the total reduction in my payments during the initial period, am I coming out ahead?"**
- **"Can I see a revised Loan Estimate with the points removed and the interest rate adjusted?"**

Interest-only ARMs

With an interest-only ARM payment plan, you pay only the interest for a specified number of years. During this interest-only period, you have smaller monthly payments, but you are not paying anything toward your mortgage loan balance.

When the interest-only period ends, your monthly payment increases—even if interest rates stay the same—because you must start paying back the principal plus the interest each month. Your monthly payments can increase a lot. The longer the interest-only period, the more your monthly payments increase after the interest-only period ends.

Payment option ARMs

Payment option ARMs were common before 2008 when the housing crisis began, and some lenders might still offer them.

A payment option ARM means the borrower can choose from different payment options, such as:

- A traditional principal and interest payment
- An interest-only payment (see above)
- A minimum payment, which could result in negative amortization

Negative amortization happens when you are not paying enough to cover all of the interest due. Your loan balance goes up instead of down.

GATHER FACTS

Learn more information about payment option ARMs and negative amortization at:

- **cfpb.gov/payment-option-arm/**
- **cfpb.gov/negative-amortization/**

WELL DONE!

Choosing the right home loan is just as important as choosing the right home. By equipping yourself with knowledge about ARMs, you can decide whether or not this type of loan is the right choice for you.

Consumer Handbook on Adjustable-Rate Mortgages

ASK YOUR LENDER

- How high can my payment go?
- How high can my interest rate go?
- How long is my initial principal and interest payment guaranteed?

ASK YOURSELF

- Have I shopped around to compare ARMs and fixed-rate loans?
- If an ARM has a lower initial interest rate than a fixed-rate mortgage, is paying less money now worth the risk of an increase later?
- Can I afford the highest payment possible with the ARM if I can't sell the home, or refinance into a lower rate, before the increase?

ONLINE TOOLS

CFPB website
cfpb.gov

Answers to common questions
cfpb.gov/askcfpb

Tools and resources for home buyers
cfpb.gov/owning-a-home

Talk to a housing counselor
cfpb.gov/find-a-housing-counselor

Submit a complaint
cfpb.gov/complaint

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