What is a 5/1 ARM?

You know, with phrases such as the title above, and the myriad of paths the mortgage industry runs us down, it's no wonder that the average consumer becomes lost in the process. Then, the mortgage market adds this new little product called the interest only loan, and presto, further confusion. Add to this fact that the interest only loan option can be added to almost any mortgage product already in existence, and you have total chaos.

Well, let's take this puzzle apart, one piece at a time. The first piece to examine is the basic loan product: an Adjustable Rate Mortgage or ARM. An adjustable rate mortgage provides the consumer with a mortgage that allows the interest rate to be adjusted at mutually agreed upon times. This means for the consumer, if the interest rate goes down, they can get a better rate. For the lending institution it means if the interest rate goes up, they get a better return on their investment. It's usually a win-win situation. The consumer generally gets a better interest rate on the front end, with the assurance that is the interest rate doesn't just explode; they'll get to keep a great rate.

Now, a 5 year ARM means that the interest rate is locked in for five years. When you add the "1" to the equation, it means it's a 1% interest only ARM for 1 month; the interest only loan option at 1% is good for the first month, then the interest only option at a normal interest rate is due for the next five years of the loan, after that point in time, the interest rate may change, and the payments will begin to include principal and interest.

The only other element to define is the interest only loan option. On an interest only loan, only the interest is paid for a specified period of time. Nothing applies to the principal; the only part that the consumer pays of the mortgage loan is the interest. That is an interest only loan.

Okay, that makes it more easily understood. But is it a better deal for the consumer today? I am inclined to disagree that an interest only loan option is the best option for any consumer, other than just a small handful, and we're not discussing those borrowers in this article. The interest only loan, whether it's tied to an ARM, or an FRM, is never a good idea when you want to pay for your home, and retire in that same home. This type of consumer comprises about 65% of the market today. So, for the vast majority, an interest only loan of any kind is not your best bet.

About the Author

John Williams writes about interest only loans at http://www.interestonlys.com