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Hybrid Mortgage Financing

In today's mortgage world there are a plethora of available mortgage financing options. Yet among these there are two basic ways to pay back money to your lender. Your choices are to either pay with a fixed rate or an adjustable rate.

Fixed rate loans generally have terms of 30 or 15 years and include a constant interest rate during the course of your entire loan. Borrowers who choose fixed rate loans prefer them for the stability of payments they provide; payments remain the same for the whole length of the loan.

Those who choose adjustable rate mortgages (ARMs) pick them for the low initial rates and payments. ARM loans work by allowing borrowers to have a below market interest rate for 1, 3, 5 or 7 years before rates become adjustable, following market trends.

If parts of both of these loans sound good to you, you may be a perfect candidate for a hybrid loan, a loan that combines features of fixed rate and ARM loans into one. Within the hybrid category there are fixed-period ARMs, convertible ARMs, two-step mortgages, and graduated payment mortgages (GPMs.)

Fixed Period ARMS

The first combination of fixed rate and ARM financing is called a fixed period ARM. This type of loan allows for an initial low rate term for anywhere from 3-10 years. After the beginning period, the interest rate will adjust based on market securities indices once a year until the end of the loan. You can often get a lifetime payment cap on fixed period loans that will prevent your payment from ever increasing over a certain amount. There are also first adjustment caps that put a ceiling on the amount of money you'll have to pay once your rate changes for the first time. This can give you a lot of peace of mind as that time nears.

The greatest benefit of fixed period ARMs is that if you choose to finance your mortgage this way, you'll get an interest rate that will generally average lower than a 30-year fixed rate, but you'll still enjoy the stability of a fixed rate period at the beginning of the loan.

Two Step Mortgages

The two step mortgage is really a variation of the fixed period ARM. This mortgage financing options allow for an initial fixed rate period of 5-7 years. After that term ends, your interest rate will adjust at that time to reflect current market averages. You will carry that rate on your loan until the end, usually 23-25 years. So you really get a fixed-rate loan during the whole loan term but the rate will change once, and you won't be able to choose that rate.

Convertible ARMs

This type of loan gives you a lot of flexibility in the rate you choose for your mortgage. Like all ARMs you will start out with a low fixed rate for a certain period of time, typically 5 years. The convertible loan permits you to lock in a rate at or before the end of that period. That means that if the market rates fall considerably during the first five years, you can ask your lender to convert your loan into a fixed-rate loan with the current market rate. The nice thing about this is that there is not much paperwork associated with the conversion and the fees are small. The downside however, is that you will probably have to pay more points at the beginning. Plus the when you convert and lock in a rate, you actually get a rate that is a little higher than the market trend.

Graduated Payment Mortgages

If you expect your income to grow over the next several years, you might want to try a graduated payment mortgage (GPM). This financing plan gives you the low initial payment schedule and then adjusts your payment up gradually at pre-set intervals. The number of years your payment will increase and the rate at which it will increase will depend on market conditions and your lender.

This type of loan is good if you plan to be in your home for a long time because at that the beginning, the payments are so low that you are actually increasing the total you owe. This is because your payments do not cover the interest owed for the period and it is tacked on to the principal of the loan. The loan makes up for this in the later years, as payments increase and the principal is paid off more quickly.

When you are considering your mortgage financing options, make sure you explore the benefits of hybrid loans for your situation. Your financial advisor or trusted mortgage professional can help you make the right decision.