Can you refinance from an ARM to a fixed rate?

Thinking about refinancing your ARM loan? Learn about the advantages and disadvantages.

When interest rates go down or ARM rates are ready to reset, many homeowners think about refinancing their adjustable rate mortgages to a fixed rate. Let's review the advantages and disadvantages.

The differences between an ARM and a fixed rate mortgage

An adjustable-rate mortgage (or "ARM") is a mortgage where the interest rate varies throughout the life of the loan. Many ARMs have an introductory rate that is set for a period of time and then may change. One popular adjustable rate mortgage is the 5/1 ARM loan which means the interest rate stays the same for the first five years of the loan and afterwards may adjust once a year. With a fixed rate mortgage, the interest rate stays the same throughout the life of the loan.

Some homebuyers choose adjustable rate mortgages because the starting interest rate can be lower than the interest rate on fixed rate mortgages. If you are planning to own a house for a shorter period of time, you might choose an ARM to take advantage of the lower monthly interest payment. For example, if you are planning to own a home for five years, you might choose a 5/1 ARM because you intend to sell the house before the interest rate adjusts.

The advantage of refinancing from an ARM to a fixed rate

Many homeowners refinance from an adjustable rate to a fixed rate mortgage because they want their payments to be more predictable. With an ARM, the amount of money you pay in interest each month can change. With a fixed rate, the amount you pay in interest will always stay the same. Many homeowners value the peace of mind that comes with knowing their mortgage payments won't change.

Keep in mind that your monthly mortgage payment includes escrow payments for your property taxes, homeowners insurance and private mortgage insurance (PMI), if your loan requires it. Your escrow payments can change whether you have an adjustable rate or a fixed rate mortgage, which can affect your total monthly payment too.

Does refinancing from an ARM to a fixed-rate mortgage save money?

That depends on many things, including the terms of your current loan, whether interest rates move up or down, and how long you plan to live in your home. Many homeowners refinance an ARM to a fixed rate mortgage when rates are low so they can “lock in” savings on interest payments. These homeowners may believe that interest rates are likely to rise in the future and by refinancing from an ARM to a fixed rate mortgage they will protect themselves from higher interest rates down the road.

Keep in mind that when you refinance an ARM, you may need to pay closing costs. Financial professionals often recommend you balance the closing costs of a refinance against the savings a new loan might offer. Many times they will recommend you calculate a “break even” point, which is the month in the future when the cost of refinancing is balanced by the savings.

Say for example you refinance your 5/1 ARM mortgage, pay $1,200 in closing costs, and save $100 a month when compared to the monthly payment on your previous mortgage. In this case, you will break even after one year ($1,200 cost divided by $100 a month savings equals 12 months). Starting in the second year of the new loan, you will save $100 a month and the longer you live in the house the more you might save. Try our home refinance calculator which includes a break-even analysis to estimate your savings. By refinancing, the total finance charges may be higher over the life of the loan.

Does keeping an adjustable-rate mortgage save money?

In the example above, most of the savings of refinancing from an adjustable rate to a fixed rate mortgage are based on the proposition interest rates will rise. That is, the homeowner is refinancing at a point in time when she believes interest rates have reached a low and may soon go higher. What interest rates will actually do in the future is hard to predict, however. And this makes it hard to know if refinancing or keeping an adjustable rate mortgage is a better bet.

Should you refinance your ARM mortgage?

One of the advantages of an adjustable rate mortgage is that it can reduce your interest payments when interest rates decline. You might get a lower monthly payment without having to complete any paperwork or pay any closing costs. And if interest rates hold steady or decline further, you might continue to save money from future interest rate adjustments.

Another question to consider before you refinance an ARM is the length of your new fixed-rate loan. There are two main factors that affect how much money you will pay in interest over the life of a loan. The first is your interest rate and the size of your monthly interest payment based on this interest rate. The second is how many years you are paying these monthly interest costs. If you refinance from an existing mortgage that has 25 years left until it is paid off to a new 30 year fixed-rate mortgage, you may take longer to pay off the new loan. And pay more money in interest as a result.

Can you refinance an ARM to another ARM?

It is possible to refinance an adjustable rate mortgage with another adjustable rate mortgage. You'll want to compare the interest rate and costs of a new ARM with your existing ARM and decide if refinancing makes sense for you.

Need more information about your ARM refinance?

Because no one can predict the future direction of interest rates, the decision to refinance from an ARM to a fixed-rate mortgage can be a difficult one. If you would like to learn more about whether an ARM refinance makes sense for you, please contact one of our knowledgeable Loan Advisors. Visit our Get Started page or call us 877-220-5533.

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