



Picking an Interest Rate

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If you are considering a HECM, you can select an interest rate that is subject to change once a month or once a year, or one that remains the same (a “fixed” rate) for the life of the loan.

Fixed Interest Rates

Fixed rate loans are attractive to most consumers, but fixed rate HECMs may be no bargain for most borrowers, as the interest rate on some of these loans has exceeded 15%.

The only way homeowners could get a realistic fixed rate from these lenders was if they agreed to take 100% of their available loan amount in a single lump sum at closing. But this meant they would be charged interest on the full amount of the largest possible loan advance, and most HECM borrowers have no need for such a large advance. So if they were to agree to a 100% lump sum, they would be paying substantial unnecessary interest charges and—by completely exhausting their loan amounts—losing the creditline growth to which they would otherwise be entitled.

On the other hand, if a borrower needed such a large loan amount, for example, to pay off the current mortgage on a home, a fixed rate HECM of this type would be worth considering.

Adjustable Interest Rates

HECM lenders must offer an interest rate that is subject to change once a year. These “annually-adjustable” HECMs can increase or decrease by the same amount as any increase or decrease in a HUD-approved interest rate index identified in the loan documents. But this rate cannot change by more than 2 percentage points up or down per year, nor by more than 5 total points over the life of the loan.

HECM lenders may also offer a “monthly-adjustable” rate that may increase or decrease each month by the same rate as any increase or decrease in a HUD-approved interest rate index identified in the loan documents. Although HUD does not require any interest rate caps on these rates, some lenders may provide them.

The index rate indices approved by HUD are the 1-month and 1-year U. S. Constant Maturity Treasury (CMT) rate and the 1-month and 1-year London Interbank Offered Rate (LIBOR), an international index widely used for adjustable rate mortgages in the United States.

Monthly versus Annually Adjustable

Monthly adjustable rates are generally lower than annually adjustable rates when based on the same rate

index. Lower rates mean larger HECM loan amounts, less growth in the amount you owe, and less growth in your available creditline funds. When interest rates fall, monthly adjustable rates drop sooner and more often than annually adjustable rates. They can also decrease by more than 2 percentage points per year and by more than 5 percentage points over the life of the loan.

The main advantage of annually adjustable HECMs are that when interest rates rise, they increase later and less frequently than monthly adjustable rates. In addition, they cannot increase by more than 2 percentage points in any year, and by no more than 5 percentage points over the life of the loan.

To date, most HECM borrowers have selected monthly adjustable rates, no doubt because they prefer the greater loan amounts and the lower initial rate charged on the loan. Some may also believe that rates are unlikely to increase by more than the caps on annually adjustable rates.

Borrowers selecting an annually adjustable rate are generally concerned that rising rates might exceed the annual rate's caps for extended periods. Without the protection of these caps, they fear, their loans balances will grow faster, so there will be a lot less equity for them or their heirs when the loan is over.

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