Rate Lock Agreements –
Should You Work with a Lender That Rate Locks at Application?

While rate lock agreements are not offered by every lender, it's important to understand rate lock agreements and what they mean for your loan. Lenders use rate lock agreements to ensure that the interest rate doesn't fluctuate while the lender is preparing the loan for closing. Typically, rate lock agreements take effect once a letter of interest or term sheet is executed, and the good faith deposit is made.

This article discusses the basics of rate lock agreements and why it's advantageous for investors to work with a lender that offers an interest rate lock option.

What is a rate lock agreement?

Since interest rates can sometimes change in a matter of hours, lenders issue rate lock agreements to protect themselves and their borrowers from fluctuating interest rates. If you close within the time frame of the rate lock agreement, your interest rate won't change from the quoted rate, and you mitigate the risk of the interest rate increasing.

Rate lock agreements protect both the borrower and lender. The borrower uses rate locks to prevent the interest rate from increasing unexpectedly and driving up their monthly payment. On the flip side, the lender uses a rate lock agreement to protect themselves if interest rates decrease and they cannot offer the borrower the new rate.

Length of rate lock agreements

Most rate lock agreements last between 30 and 60 days, although in some cases, the rate lock can last for up to 75 days. Some of our lending partners can lock the interest rate for 45-75 days after the loan application, term-sheet, or letter or interest is signed, and the good faith deposit is wired.

Some lenders may offer their borrowers a free rate lock for a certain time and then charge a fee to extend the rate lock agreement if the loan doesn't close within the original rate lock period.

Contact us now to discuss your financing options:
(435)-785-8350 | Info@madisongroupfunding.com | Schedule Appointment

How much does a rate lock cost?

The cost to lock an interest rate in while the loan is being prepared to close can vary. Some lenders will charge a 1% fee to rate lock, while others offer rate lock options for free. Below are some fee structures The Madison Group has seen over the years:

- Lender provides rate lock for no fee
- Lender collects a 1% fee to rate lock and then reimburses the investor the 1% fee at closing
- Lender charges a 1% fee to rate lock
- Cost for rate lock is embedded into the interest rate the investor is offered

No matter what the structure is, it’s important to know the terms of the deal and potential costs by talking with your lender before signing the rate lock agreement.

When to lock your interest rate

Borrowers may think that locking your rate too early may cause them to miss opportunities on lower interest rates. While this may be true in some cases, interest rates are steadily increasing in today’s economy, and it’s unlikely that there will be lower rates available in the near future. Each situation is different, and investors should take time to consider the risks and benefits for their unique scenario.

So, when should you lock your interest rate? The lender should lock the interest rate once the borrower signs the application and wires the good faith deposit. Locking in the interest rate at this point ensures the lender and the borrower are protected from market conditions that affect interest rates.

Risks of commercial mortgage rate locks

Commercial mortgage rate locks are common in today’s commercial real estate financing market. However, there are some risks that you should be aware of before you decide to lock the interest rate with a lender.

Sometimes, borrowers will walk away from the agreement altogether to take advantage of the lower rates with a different lender when interest rates fall during the rate lock period. Some lenders are known to allow the lock periods to expire when interest rates rise and make it seem like the borrower didn't produce the necessary paperwork on time. It's important to know the lender you are working with and understand their process.

Longer rate locks also typically mean a higher interest rate. The price of rate locks tend to be lower on shorter fixed rate periods since there is a lower risk of a change in interest rates due to market fluctuations. Lock agreements that expire before closing can sometimes be extended for an additional fee.

Lenders may put a cap on the amount that a rate adjusts to if market conditions cause rates to rise. For example, if a borrower locked their interest rate at 6 percent and it increased to 6.5 percent, there would be a limit on the amount that your rate adjusts even after the rate lock. This provides some protection for borrowers against rising interest rates.

How to lock in your interest rate

Typically, commercial mortgage lenders won't lock the interest rate right away. They will need to do a preliminary review of your financial situation before locking the interest rate. In some cases, the lender may need to run a credit report and ask for required documentation, including:

- SSN verification
- Two or three years of business tax returns
- Two or three years of personal tax returns for each guarantor/owner
- Personal financial statement and schedule of real estate for each guarantor/owner
- Year-to-date profit and loss on the commercial real estate
- Proforma for the next 12 months on the commercial real estate

Once the lender reviews your credit score and financial situation, they will give you a quote for the interest rate that they can approve you for. This is the time to ask for their rate lock agreement details. The lender will discuss their policy on rate locks and give you the option to submit a request to get the lock process started.

Changing lenders after a rate lock

A common question when discussing rate locks is whether or not you can change lenders after the lender locks your rate.

It's important to understand that rate lock agreements usually don't lock you into a loan. You are typically free to walk away from the loan at your discretion, but there are several downsides to doing so. First, you've likely spent a lot of time working with this lender. They have run your credit, you have paid for the rate lock agreement, and the third-party reports may be underway. It may not be worth the hassle to switch lenders this late in the process. Additionally, you may deteriorate the relationship with the lender for future deals.

The importance of rate locks

We can't emphasize the importance of rate locks enough. In the case of commercial real estate, borrowers may promise a certain return for investors. A sudden change in interest rates could ruin the return promised by the borrower and terminate the deal.

For more information on how to get started working with us as your trusted commercial real estate financial advisor, visit our website, give us a call at 435-785-8350, or email your loan scenario to info@madisongroupfunding.com.