

# DCC DOLLARS & \$ENSE

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## Mortgages

### *Special points of interest:*

- Types of mortgages available
- Which is right for you?
- Benefits of each option

There are several different types of mortgage options available to consumer. Last October we featured Interest Only Mortgages and the benefits and shortcomings they offer. This month, we're going to evaluate some of

the other mortgage options available to consumers.

**Fixed Rate Mortgages-** A mortgage with an interest rate that does not change during the entire term of the loan. These are typically available in 10,15,20 and 30, year terms.

### **Short Terms** 10 to 15 years

Have lower interest rates

Have a shorter period to pay back the principle- because of the shorter term the monthly payments are higher, but it allows more to be applied towards the principle and less to interest each month.

- Builds equity faster
- Have higher monthly payments- because of which you may qualify for a lower loan amount
- Are a good choice if you'd rather build equity faster and pay less in interest than buy a more expensive home

### **Longer Terms** 20 to 30 years

- Qualify for a larger loan amount
- Have higher interest rates
- Will have a lower monthly payment
- Are a good choice if you don't plan to move or refinance for at least ten years or if interest rates were low when you locked in the rate

**Adjustable Rate Mortgages (ARM)-** Also known as a variable-rate loan, usually offers a lower initial rate than fixed-rate loans. The interest rate can change at specified time periods based on changes in an interest rate index that reflects current finance market conditions, such as the LIBOR index or the Treasury index. The ARM promissory note states maximum and minimum rates. When the interest rate on an ARM increases, the monthly payments will increase and when the interest rate on an ARM decreases, the monthly payments will be lower.

It's important to understand all the aspects of an adjustable rate before you make your decision. These are some things consider;

Benefits to an Adjustable Rate Mortgage include;

- Adjustable Rate Mortgages have a lower initial interest rate then a fixed rate mortgage. The difference may qualify your for a more expensive home.
- Adjustable Rate Mortgages are a good choice if interest rates are high when you're looking to close.

## Mortgages Cont.

Other things to consider;

Adjustable Rate Mortgages have defined adjustment periods to determine how often the interest rate can change. The initial period could be as short as one to three years, or as long as seven to ten. After that the rate is usually adjusted annually.

Once the initial period is up, the interest can be adjusted based on an index plus additional points, known as the margin.

There are limits to the amounts that an interest rate can increase or decrease on the first change date after the initial period, on each subsequent periodic adjustment and over the life of the loan. As an example a interest rate may have a cap of 3-5 percent over the life of the loan and never be increased more than 1% in an adjustment period. Meaning it could go up 1% per year however would never go higher than the original percentage plus 5%.

Consumers should always look to see what the maximum interest rate could be. There is generally no limit on the possible reductions, but the cap of the interest rate is important.

**Balloon/Reset Mortgage-** A mortgage with monthly payments based on a 30-year amortization schedule and the unpaid principal balance due in a lump sum payment at the end of a specific period (usually 5 or 7 years) earlier than 30 years. The mortgage contains an option to reset the interest rate to the current market rate and to extend the maturity date provided certain conditions are satisfied.

Specifics of Balloon/Reset Mortgage include;

- The monthly payment schedule of a Balloon/Reset Mortgage is based on a 30, year amortization schedule.
- At the end of the Balloon period (typically 5-7

years) the balance of the mortgage becomes due. This might be a good option for consumers that do not plan to be in the home for that long. A good example would be if you were purchasing the home with the intent to remodel and sell it as an investment property.

After the balloon period is up, a consumer can “reset” the mortgage at the published market rate at that time.

Balloon/reset mortgages typically come with a slightly lower initial rate than many other mortgage types.

### **Bi-Weekly Mortgage Payment Option**

This is a fixed-rate mortgage in which payments are made every other week, instead of monthly. Typically, it is a method used to shorten the term of a 30-year mortgage. Simply stated this works by taking your monthly payment amount, and dividing it by two, and then you pay that amount every two weeks. That means you will be paying 26 "half-payments" a year the equivalent of 13 monthly payments, with the 13th monthly payment applied entirely to the principal balance. This simple adjustment has a dramatic impact on the length of the loan, a 30-year loan can be paid off in about 23 years through this method. The important part of changing to a Bi-Weekly mortgage is making sure your lender accepts your payments and correctly credits the extra portion to principle.

With all of the different options available for mortgages a consumer may find themselves at a loss for understanding. Each option will have it's own features that will make it appealing or less desirable. It will ultimately be up to where the consumer stands and what they are hoping to accomplish. A consumer should speak with their mortgage broker to see what options are best for them.