

Interest Rates and Mortgage Loans: How to Select Wisely

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Selecting a loan that is right for you is one of the most important financial decisions you will make, whether it is to purchase a home, vehicle, go to school, or to pay for another personal expense. Mortgage options are probably the most complicated for the average consumer to navigate. Your community bank can explain the variety of mortgage programs it offers and help you make the best choice. Finding information online is easier than ever on banks' websites, which might include a calculator function to help you crunch the numbers. Still, it doesn't hurt to do your homework on how different mortgages work before an initial meeting with a loan officer. Most mortgages fall into one of several general categories.

Fixed Rate

Fixed rate mortgages are the traditional loans that have a set interest rate over the life of the loan. The most common terms are 15 or 30 years. With these loans, your monthly payment for interest and principal never changes. This payment amount is independent of the additional costs on a home sometimes handled in escrow, such as property taxes and property insurance. Therefore, payments made by the borrower might fluctuate slightly over time with the changing escrow amount, but the payments on the principal and interest on the loan remain the same. There is a 20% down payment requirement for a conventional fixed rate loan however as low as 5% down payment is required when the loan is further enhanced with Private Mortgage Insurance (PMI), a default insurance policy that insures the loan to the bank

If you can afford it, it may benefit you to consider a 15-year mortgage instead of the more common 30-year mortgage. Imagine owning your home free and clear before you retire, or even before your children start college. Because you are paying interest for only 15 years versus 30 years, you will save a significant amount of money over the life of your mortgage. While the monthly payments are a bit higher on a 15-year mortgage, these interest savings make the 15-year option much less expensive over the life of the loan.

A summary of the advantages of a 15-year mortgage versus a 30-year mortgage:

- Build equity much more quickly
- Own your home in half the time
- Save more than half the amount of interest

Bi-Weekly Mortgage Payments

A bi-weekly mortgage payment plan is another option to consider. This plan works by automatically deducting half of your monthly payment from your checking account every two weeks. Making bi-weekly payments instead of monthly payments allows you to save up to eight years of payments and interest on a 30-year mortgage. Then you can start facilitating other planned financial goals such as college and retirement funds. Set up and transaction fees may apply to manage your account, be sure to check with your community bank for more details.

Adjustable Rate

Adjustable rate mortgages (ARM) typically start at a lower interest rate - and lower payments - but interest rates and payments change with market interest rates. A typical ARM is adjusted on an annual basis (although some are adjusted less frequently), and increases are usually capped for any given adjustment period and for the life of the loan. Additionally, some ARMs let borrowers take advantage of a fixed rate for the beginning years of the loan (usually 3 or 5) after which the rate can adjust to market conditions. If you're planning to stay in a home for only a few years and you can get an ARM for significantly less than a fixed rate mortgage, you may come out ahead by going for the ARM. Be aware however, that most lenders charge a prepayment penalty, typically within the first three years, if you payoff or refinance an ARM. Adjustable rate mortgages are also popular with people who may have difficulty qualifying for a loan at higher fixed interest rates. The lower initial ARM rate lowers their monthly payment in the early years of the loan, making it easier for them to qualify for the loan. Just be sure that in later years of the loan if rates increase you can afford the higher monthly payments.

Interest-Only Loans

Some lenders advertise an interest-only option as a way for you to get "more house for less money." Unfortunately, that can lead to serious financial trouble. If you take on an interest-only loan, you'll eventually have to make up for all the months or years you weren't paying on the principle, and your payments will increase. Using an interest-only option does not increase the length of the loan. If you have a 30-year mortgage, and exercise an interest-only option for 5 years, you then have only 25 years to pay off the principle instead of 30, which means your payments increase for the remainder of your loan. You should only choose the interest-only option on your mortgage loan if you need some flexibility in your payment amount from month to month. An interest-only option is great for someone who works mainly on commission, such as a salesperson. The loan allows him or her to pay just the interest on a mortgage during a slow month on the job, but not be charged a penalty or late fee for not paying the principal.

Balloon Mortgages

If you know you'll be moving in five to seven years, and you'd like a lower interest rate but are uncomfortable with an adjustable rate, the balloon mortgage may be a good choice for you. These loans often have a somewhat lower interest rate than a conventional 30-year mortgage, but the loan is due in full in five to seven years. If you're still in the house at the end of the term, you'll have to find another mortgage in order to make the balloon payment of 100% of the principal of your current mortgage.

Refinancing

If rates have declined since the time when you got your current mortgage, you might be able to save money by refinancing. The decision to refinance your home depends on many things, including how long you plan to keep the house, how much lower the interest rate will be on your new loan, the closing costs for the new loan, your equity in the home, and whether refinancing can eliminate your private mortgage insurance. In some cases, even if you can't lower your monthly payment, it might make sense to refinance to gain the security of a fixed rate. Be aware that to take advantage of a lower rate you'll have to close on a new loan and pay the related closing costs. Another

potential pitfall of refinancing is that the clock starts again at day one. If you refinance your 30-year mortgage on a regular basis - say, every three or five years - and you make only the minimum payments, then you will not make significant reductions of your loan's principal balance unless you refinance for a shorter term or pay more than the set monthly payments.

For most people, by the time they finish paying off the mortgage on a house, they will have paid more in interest alone than the actual purchase price of the home. It makes sense to shop wisely for the best mortgage, since it will probably be the biggest financial decision of your life. Be sure to take advantage of some of the online tools your community bank offers, which will help you be better informed so you can choose the mortgage that works best for you.