Which Mortgage Is Right For You?

By ALEX MASON | Green Shoot Media

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Deciding between a fixed-rate and adjustable interest rate for your mortgage can be a balancing act. Your lender can explain the potential benefits to both types of loans.

Finding the right loan to meet your budget starts with sitting down with a mortgage professional to discuss your options.

Never settle for anything but the best, and be sure to discuss your intent for the property and how long you anticipate remaining in the home. Your loan officer will take into account your income and credit rating to secure the best interest rates, and they will offer a points buy-down option to reduce the loan balance.

Most importantly, he or she will explain the difference between an adjustable rate mortgage, or ARM, and the popular fixed term loan for 15, 20, 30 or 40 years. There are pros and cons on both sides of the fence, so careful evaluation of your unique set of circumstances will lead you to the right loan product to get you into your dream home.

ARM LOANS

The adjustable rate mortgage (ARM) is an attractive option for easy monthly payments and the chance to lock in a current low interest rate. The ARM loan product will be set to adjust on a two-, five- or seven-year term period, at which time the monthly payment may increase if the current interest rate conditions are unfavorable.

A higher interest rate may be due to nationally set standards or may be affected by the borrower's credit score taking a nosedive for reasons they were not able to control. Medical bills, emergencies and a host of unpleasant financial surprises can make the ARM loan risky business if the resident plans to hang onto the home and stay there for many years.

The ARM may be the ideal funding situation for borrowers who anticipate a short-term stay in the property or wish to rehab the home while they are living there and sell the property before the ARM adjusts. The ARM loan product is typically lower than a fixed rate, but the long-term goals of the resident and careful analysis of the borrower's budget must come into play.

FIXED-RATE LOANS

The fixed-rate loan is the most popular and dependable loan product for borrowers who wish to remain in the home for many years.

This type of mortgage may be set for a payoff according to the borrower's ability to handle the monthly mortgage. If you are able to make a higher payment, ask your loan officer for his or her best rate on a 15-year contract. However, if you prefer to free up your monthly cash flow and can anticipate the loan balance to be paid off before retirement, the extended 30- to 40-year fixed rate ensures a steady monthly mortgage payment with no surprises down the road.

Fixed-rate mortgages are a bit more expensive than ARMs, but the peace of mind and stability they provide are well worth the extra interest. The down side to the ubiquitous fixed-rate mortgage is that the borrower will not be able to take advantage of better interest rates without a costly home refinance.

Refinancing a property requires sufficient equity and an official appraisal above the new loan amount to be compliant with lending institution regulations. Sold as the No. 1 loan product for savvy buyers, the fixed-rate mortgage helps keep your financial status in check for long-term planning and the security that the payment is guaranteed for the life of the loan.

Ask your loan professional to explain all your mortgage options and rest assured that your educated decision will be right for you.

Alex Mason is a former real estate agent and mortgage broker living in Los Angeles.

REAL ESTATE 101

Know Before You Shop

USA.gov offers the following pros and cons for various mortgages:

Fixed-rate mortgage
Pros: No surprises The interest rate stays the same over the entire term, usually 15, 20 or 30 years.
Cons: If interest rates fall, you could be stuck with a higher rate.

Adjustable-rate (ARM) or variable-rate mortgage
Pros: Usually offers a lower initial rate of interest than fixed-rate.
Cons: After an initial period, rates fluctuate over the life of the loan When interest rates rise, generally so do your loan payments.

FHA (Federal Housing Administration) loan
Pros: Allows buyers who may not qualify for a home loan to obtain one Low down payment.
Cons: Size of loan may be limited.

VA loan
Pros: Guaranteed loans for eligible veterans, active duty personnel and surviving spouses Offers competitive rates, low or no down payments.
Cons: Size of loan may be limited.

Balloon mortgage
Pros: Usually a fixed rate loan with relatively low payments for a fixed period.
Cons: After an initial period, the entire balance of the loan is due immediately. This type of loan may be risky for some borrowers.

Interest-only
Pros: Borrower pays only the interest on the loan, in monthly payments, for a fixed term.
Cons: After an initial period, the balance of the loan is due. This could mean much higher payments, paying a lump sum or refinancing.

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HOMEWISE GLOSSARY

Balloon/reset mortgage:: a fixed-rate, level-payment Home Mortgage with monthly principal and interest payment based on an amortization schedule calculated to pay the original principal balance in full in 360 months. The unpaid principal balance of the balloon note is due as a lump sum on the balloon maturity date, and the Borrower has a reset option at the balloon maturity date.

SOURCE: U.S. Department of Housing and Urban Development