SEN$IBLEinformation

The Basics of Mortgages

Because of the high cost of most real estate, very few people can purchase a home with savings alone. Therefore, if you are like the vast majority of people, you will be borrowing money from a financial institution to purchase the property you want. Called mortgages, these loan products can be quite complicated. Knowing the basics of how mortgages work can help guide you to the loan that is most appropriate for you.

MORTGAGE TERMS

How long is it going to take you to repay the loan? That depends on the term of your mortgage. A term is the number of years that you agree to pay back the amount you borrow.

The term also affects the cost of your mortgage payments. Shorter repayment periods mean higher monthly payments but less interest you pay over the life of the loan, while longer terms will give you lower payments but will cost more over the long run. The traditional mortgage term is 30 years, but they can range from ten to 40 years.

TYPES OF MORTGAGES

There are several types of mortgages available, with the most common being fixed-rate, adjustable, and interest-only.

Fixed-rate mortgages come with an interest rate that remains constant over the life of the loan. 30-year mortgages are the most common, but you may also choose a 20-year, 15-year, and even 10-year fixed-rate mortgage. In certain high-cost areas some mortgage lenders are even offering 40 year-loans. Though the mortgage interest rates tend to be higher than for other loan types, the rate is fixed and your payment won’t change. This stability makes them the most secure type of mortgage for buyers.

Adjustable-rate mortgages (ARMs) have a period of fixed interest, but after that the payment changes with whatever index the loan is based on. The period of fixed interest may be three, five, or seven years. With a 5/1 (the first number stands for the number of years in the initial fixed period, while the second indicates how often the new rate will adjust) ARM, for example, the initial interest rate remains fixed for the first five years, and then adjusts annually for the remaining term.

There are several types of caps that may apply to an ARM: an overall cap limits how much the interest rate can increase over the life of the loan; a periodic cap limits the amount the interest can increase from one period of adjustment to the next; and a payment cap limits the amount the monthly payment can increase at each adjustment.

While ARMs are less secure than fixed-rate mortgages, they tend to have lower initial rates and therefore lower monthly payments. They can be a good option if money is tight in the early years, as long as you are confident you can meet future interest and payment increases.

Interest-only mortgages are loans that allow you to pay just interest for between three and ten years. Once that period is over, the payment rises to include both principal and interest. While qualification can be easier and the monthly costs can be lower than other mortgage types, they can be a gamble. A downturn in housing prices could mean that you end up owing more than you own, and an interest rate hike could put the payments beyond your reach.

Certainly there are benefits and drawbacks to each mortgage type. Long before you borrow, consider each option carefully to know which is most appropriate for your situation. With so much money at stake, making the best mortgage decision is important.

Call 215.721.2583 or email mortgages@univest.net for help in determining which mortgage solution is best for you

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