Mortgage 101

Fixed-Rate Mortgages

A fixed rate mortgage keeps the same interest rate for the life of the loan. For most people, especially first time homebuyers, this is the best option because you pay the same monthly principal and interest rate.

A fixed-rate mortgage means the interest rate and the payments remain the same for the entire life of the loan (taxes, of course, may change.) Advantages include consistent principal and interest payments, making this loan stable. In other words, your rate won't change, so you don't need to worry about market fluctuations.

Disadvantages include a possibly higher cost. These loans are usually priced higher than an adjustable-rate mortgage. Keep in mind that, on average, most people move or refinance within seven years. If rates in the current market are high, you're likely to get a better price with an adjustable-rate loan.

- 30 Year Fixed-Rate Mortgages offer consistent monthly payments for the entire 30 years you have the mortgage. So if the market is good, you can benefit from locking in a lower rate for the full term of the loan.
- 20 Year Fixed-Rate Mortgages allow you to make a consistent monthly payment throughout the 20 years you have the mortgage. The shorter term means you pay the loan off more quickly, and therefore pay less interest. And you'll build equity faster than you would with a 30-year loan. (But remember the shorter term means higher payments, when compared to the 30 year fixed-rate mortgage.)
- 15 Year Fixed-Rate Mortgages provide consistent monthly payments for the 15 years you have the mortgage. By building equity even more quickly than with a 30 year or 20 year loan, and paying less interest, you'll save money in the long run. It's an ideal option if you can handle the higher payments and if you'd like to have the loan paid off in a shorter period of time - for instance, if you plan to retire.

Adjustable-Rate Mortgages

An adjustable-rate mortgage (ARM) is one that the interest rate changes over the life of the loan - according to the terms specified in advance. The interest rate fluctuates based on several money market indexes, which cause the cost of funds for lenders to vary. All ARMs are amortized (paid down) over 30 years.

With ARMs:

- The initial interest rate is usually lower than with a fixed-rate mortgage.
- The monthly repayment would also be lower.
- The interest rate may be adjusted (up or down) at predetermined times.
- The monthly payment will then increase or decrease.

ARMs are usually priced lower than fixed-rate mortgages so you can increase your buying power and lower your initial monthly payments. If interest rates go down, you'll enjoy lower payments. Usually an ARM is the best choice for homeowners who plan to relocate (for example, with their company or the military), or for those who are purchasing their first home and plan to be in the property only for three to five years. Remember that, on average, most people move or refinance within seven years.

Conversely, monthly payments could increase if monthly payments if interest rates go up. Keep in mind that ARMs are best for homeowners who aren't planning on staying with a property for a long period. If you're on a fixed income, an ARM (especially a short-term ARM) may not be your best choice.

10/1 Adjustable-Rate Mortgages provide a fixed initial rate of the loan for the first ten years of repayment. After 10 years, the rate adjusts every year thereafter for the remaining life of the loan. The loan is amortized over 30 years.

7/1 Adjustable-Rate Mortgages offer an initial rate that is fixed for the first seven years of repayment, then the rate adjusts every year thereafter for the remaining life of the loan.

5/1 Adjustable-Rate Mortgages mean the initial rate remains fixed for the first five years of repayment, and then adjusts every year thereafter.

3/1 Adjustable-Rate Mortgages provide three years at the initial fixed-rate, then the rate adjusts every year for the remaining life of the loan. A good choice if you expect to move or refinance in a relatively short period of time. But a much shorter fixed-rate period means your interest rate (and therefore monthly payments) may begin to fluctuate after three years.

New Construction Loan

If you are working with a builder in a sub-division or development you may be able to obtain a standard mortgage loan. But if you're hiring contractors, electricians, plumbers, and painters, you will probably need a construction loan, which provides funds to pay subcontractors as work progresses.

Assumable Loans

Assumable loans permit one borrower to take over a loan from another borrower without any change in the loan terms. Such loans still exist but they aren't very common or popular (for buyers) in a low-interest-rate environment. Plus, today new assumable loans are almost always adjustable rate mortgages. To find out if a loan is assumable, look to the loan agreement to determine if it is assumable by someone else, then talk to the lender about specific requirements based on the value of the home.