THE ABCs OF MORTGAGES

By Jacob Ansel

MORTGAGES CAN BE COMPLEX AND confusing and difficult to understand. When you apply for a mortgage, brokers and banks provide you with so many options it's difficult to know which one is right for you. Thirty-year, 15-year, interest only, principal and interest, broker or bank, cash out? What's best for your home, investment purchase, or refinance. Here's a basic primer of the mortgage market.

A 30-year mortgage carries a higher payback payment than a 15-year mortgage (all that extra interest), but if you can pay off the mortgage in 15 years that's a smart way to go. Fifteen-year mortgages generally offer lower rates than 30-year mortgages which can save a great deal in the long run. Most folks worry if they can afford the higher monthly payment and prefer not to be locked in. Here's a simple solution: take a 30-year mortgage and pay it down in 15 years. Hire a company that charges a nominal fee to make 26 payments a year bi-weekly which will save five years on a 30-year mortgage. Then pay down the principal with an amount that shaves off the remaining ten years. If you ever get stuck and can't afford the 26 biweekly payments or the extra principal payments, simply go back to paying your mortgage over 30 years at the set monthly payment.

What's best? An interest-only loan or a fully amortizing interest and principal loan. Interest-only loan payments are substantially less than fully amortizing loans. These loans help you buy a more expensive home. What can you do with the money not being used to pay down the principal balance? Let's say the interest payment is $1,400 monthly while interest and principal is $2,200 a month. What would you do with the $800 principal to make more money than the average 3.75% mortgage rate? Do you buy stocks, bonds, an investment property? If you can beat the 3.75% rate, then yes, do something. The assumption is your house will increase in long-term value creating a substantial difference so you'll be in a better financial position.

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A mortgage is a legal contract between a lender and a borrower that uses property as collateral to secure a loan. Mortgages may seem complicated to first-time home buyers, so discuss all mortgage details with your lender before signing any documents. And if there are terms you don't understand, seek help.

Should you use a bank or broker to refinance or purchase a home? Mortgage brokers work as middlemen between banks/mortgage lenders and borrowers on the wholesale end to secure financing for homeowners. Banks and lenders work directly with homeowners. Mortgage brokers account for more than 10% of all home loan originations. Their share of the mortgage pie was as high as 30% during the mortgage boom, but fell after the mortgage crisis. Brokers do all the legwork for you, comparing bank and lender rates. They can finance tricky deals because of their knowledge and affiliated lending partners and can be easier to get in contact with. On the other hand, they may overcharge you since this is how they make money.

Working directly with a bank helps if you already know the banker who'll be handling your mortgage, they're more accountable than smaller shops, and can offer lower interest rates. Conversely, banks are bureaucratic – the mortgage application can be a lengthy process, and they may overcharge you.

If you have equity in your house, should you continue to pay down the mortgage or refinance for additional cash? If your intention is to go on a shopping spree or a mid-life crisis buying run then NO! Absolutely not. Do not refinance for a quick fix. But if you want to purchase an investment property then yes since you're paying a low rate of interest to purchase a property that should increase in value at a higher rate than the mortgage.

An often asked question is – is it worth cashing out to pay off credit card debts. This is a tough one and depends on the case, but more often than not the answer is no. If you face a real emergency and have no other safety net, it's acceptable. But a second mortgage puts your home at risk of foreclosure if you're unable to make the payments. Because you're borrowing against the value of your home, this can make it more difficult to sell the property if the need should arise. Your sale price would have to cover not only your primary mortgage, but your second one as well. It's a complicated decision and the best suggestion is speak to an experienced financial advisor. ❑