

MORE ABOUT INTEREST ONLY LOANS

Last week I pointed out that even after the first 5 years of a loan, a fully amortized payment would not result in much of a decline in the mortgage balance, making an interest only loan a reasonable option. That scenario assumed a fixed rate loan (with interest only payments). Now let's look at an interest only loan combined with an adjustable rate. With an adjustable rate, payments will change based on predetermined events (at specific times or when the index values change). Whether or not that payment is interest only or an amortized payment would, *in theory*, not matter since you are *presumably* prepared for a changing payment. The real problem, rarely clarified for consumers is this: **how long will the interest only payment be allowed?** That's the real issue. If you have an adjustable rate loan with interest only payments for say, 3 years and the rate first adjusts after that 3 year period ends, your interest only payment usually disappears. Now the payment has not only changed, it's no longer interest only....it's now **fully amortized!** That's a double hit! **THIS** is where the problem is. It's not just that it's interest only and it's not that an adjustable rate loan is a terrible loan, it's that both changes happened at the same time. If the borrower is not fully informed and ready for this change (and/or prepared to refinance at that time if need be), terrible things can happen, including the loss of a home. It is so important to work with a knowledgeable broker who will explain these critical details to you....those details can make or break your dream of home ownership!

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