

INTEREST ONLY LOAN VS. FULLY AMORTIZED LOANS

We keep hearing in the news that it's nothing but doom and gloom for people who selected interest only loans for their home purchases. Is there something horrific that is about to happen to these people because they chose an interest only loan? Not necessarily!

Let's take a look at a 30 year fixed rate fully amortized loan. A fully amortized loan is one with equal monthly payments due on a regular basis until the loan is paid in full. Amortized mortgage loans pay more toward interest in the early years than to principal. Take a 30 year, fixed rate loan of \$300,000 for example. Let's assume the interest rate is 6.5%. The principal and interest payment would be \$1896. Want to know something interesting? Of that payment, a whopping \$1625 goes toward *interest only* (and then slightly less each month as more starts going toward principal).

Let's see what happens over the first 5 years of this loan. At the end of year 5, of that same payment of \$1896, \$1523 is still going toward the *interest only* portion of the loan! Very little of the principal has been paid down and the loan balance is still \$280,833.

How does that compare with an interest only loan, assuming the same amount and interest rate? The interest only payment has been \$1625 every month and at the end of 5 years, the balance is still \$300,000. The point of this is that after 5 years with a fully amortizing loan, *you will have only paid the loan down by \$20,000~* and obviously, with an interest only loan, the balance is still where you started.

The difference of a payment of \$1896 (fully amortized) and \$1625 (interest only) is substantial to many homeowners and choosing an interest only loan can still make very good sense. Listen to your mortgage professional and look closely at *all* of your options! What you hear on the news isn't always correct for you.

Next time, more about interest only loans. What happens with interest only combined with an adjustable rate? That might be a whole new story!