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Interest Only Home Loans – Be Careful In Choosing This Option

Interest only loans are an old idea that has recently returned to the mortgage market. They were used up through the 1920's and died out when many borrowers ended up losing their houses during the depression. Interest only loans are not mortgages, but rather, are payment options that allow the borrower to pay interest only payments for a fixed period of time, usually 3 to 10 years. The benefits of this type of loan are that they allow a borrower to make a lower monthly payment when they first buy a house or to buy a more expensive house initially, but make the same monthly payment as they would on a less expensive house. Interest only loans are typically used when a buyer's monthly income fluctuates, or they anticipate a higher salary or a reduction in expenses, such as paying off a debt, in the near future. This type of loan works well if a borrower plans to make a larger mortgage payment later when they are better able to afford it or they plan to sell the house before the end of the interest only term. A borrower can still convert the loan to a standard fixed-rate loan if they don't move as anticipated or increase the amount of the monthly payment to start paying down the principal of the loan during the interest only period. The payment on an interest only loan is fully tax deductible which is good if a borrower is in a high tax bracket. This can also be a way to increase wealth by accumulating assets; however, paying down the mortgage balance, reducing your liability, is the best way to build wealth.

There are several downsides to making an interest only loan. During the interest only period the borrower pays only the interest on the loan so the loan balance stays the same during the term of the loan, none of the payment is applied to the principal of the loan and no home equity is built up. If you pay \$500 a month for 10 years on a \$100,000 loan you still owe \$100,000 at the end of the 10 year payment period and if the property values have declined you can end up owing more than the house is worth. On an adjustable rate mortgage the interest rate during the interest only payment period may or may not be fixed. Some loans have an initial low interest rate for only the first 6 months and then the interest rate jumps up. If a borrower has a \$100,000 loan with an initial rate of 4% they would pay only \$333 a month for the first 6 months, but if the rate goes up to 6% after that period then the payment would go up to \$500 a month which could cause some borrowers to lose their house.

Interest only loans are generally best for people who have the best credit rating, a good cash flow and are willing to refinance or move when the interest only payment period ends. This type of loan can help someone with a lower income get into a house that they might not be able to afford with a standard fixed-rate mortgage, but there is also a chance that they may lose the house when the interest only period ends and the monthly payment increases. Interest only loans can be a good choice if the interest rates are high when a buyer is looking to get into a house; however, if the interest rates continue to go up the borrower may be stuck with an interest rate that leaves no room for saving money or a mortgage the buyer can't pay. If you are considering an interest only loan do your research, compare the options carefully and beware of the negatives of this type of loan.

For more information about interest only home loans you may wish to call the Illinois Department of Financial and Professional Regulation at (217) 785-2900 or visit our website at <http://www.idfpr.com/>, or visit any of the following websites:

<http://www.fdic.gov/consumers/consumer/news/cnsum05/mortgages.html>

<http://www.federalreserve.gov/BoardDocs/Press/bcreg/2005/20051220/default.htm>

<http://www.pueblo.gsa.gov/cfocus/cfmortgage05/focus.htm>