Specialty Mortgages: Risks and Rewards

In high-priced housing markets, it can be difficult to afford a home. That's why a growing number of home buyers are forgoing traditional fixed-rate mortgages and standard adjustable-rate mortgages and instead opting for a specialty mortgage that lets them "stretch" their income so they can qualify for a larger loan. But before you choose one of these mortgages, make sure you understand the risks and how they work. Specialty mortgages often begin with a low introductory interest rate or payment plan — a "teaser"— but the monthly mortgage payments are likely to increase a lot in the future. Some are "low documentation" mortgages that come with easier standards for qualifying, but also higher interest rates or higher fees.

Specialty Mortgages Can:

- Pose a greater risk that you won't be able to afford the mortgage payment in the future, compared to fixed rate mortgages and traditional adjustable-rate mortgages.
- Have monthly payments that increase by as much as 50 percent or more when the introductory period ends.
- Cause your loan balance (the amount you still owe) to get larger each month instead of smaller.

Common Types of Specialty Mortgages:

- **Interest-Only Mortgages:** During the initial phase of an interest-only mortgage, typically the first 5 to 10 years, your monthly payments exclusively cover the interest on the loan without reducing the principal amount borrowed. After this period, the payment structure changes to include both principal and interest, resulting in higher monthly payments for the remainder of the loan term.
- **2:1 or 3:1 Buydown Mortgages:** This mortgage product gives you a lower interest rate for the first 2 or 3 years (which is the reason for the names 2:1 or 3:1). After this introductory period, the interest rate returns to the original rate you initially agreed upon. To secure this reduced rate early on, there's a one-time fee paid at the closing of your home, which can be covered by either you or the seller. This arrangement helps make your early mortgage payments more affordable. The goal is to allow you to refinance into a mortgage with a lower, fixed rate before the period of the reduced rate ends.
- **Option Payment ARM Mortgages:** This mortgage type provides multiple monthly payment options, including a minimum payment that may not cover the interest, leading to an increase in the loan balance; an interest-only payment; or a fully amortizing payment calculated over 30 or 15 years. This flexibility allows

borrowers to manage their cash flow more effectively, though it comes with the risk of increasing the total loan amount if only minimum payments are made.

- **40-Year Mortgages:** Extending the amortization period to 40 years reduces the monthly payments compared to a traditional 30-year mortgage, making homebuying more accessible by lowering the monthly financial burden. However, this comes at the cost of significantly increased interest payments over the life of the loan due to the extended repayment period.

Questions to Consider Before Choosing a Specialty Mortgage:

- How much can my monthly payments increase and how soon can these increases happen?
- Do I expect my income to increase or do I expect to move before my payments go up?
- Will I be able to afford the mortgage when the payments increase?
- Am I paying down my loan balance each month, or is it staying the same or even increasing?
- Will I have to pay a penalty if I refinance my mortgage or sell my house?
- What is my goal in buying this property? Am I considering a riskier mortgage to buy a more expensive house than I can realistically afford?

Be sure you work with a real estate professional and lender who you trust and are capable of explaining the different options for mortgage financing and address all of your questions and concerns!

For more information or assistance, contact me: Erica Anderson @ Real Premier Team powered by RE/MAX Fine Properties
📞 Phone: (480) 599-6811| ✉ Email: Erica@RealPremierTeam.com
🌐 Visit my website: www.RealPremierTeam.com