

Loan Advice

30 year fixed? ... Adjustables? ... 15 year fixed?
Some things to consider ...

Are you inadvertently getting bad advice? Take steps today to help avoid pitfalls that can cost you thousands of dollars.

As real estate agents, we're not supposed to provide our clients with tax or legal advice. Nevertheless, agents routinely provide advice that can save or cost their clients a tremendous amount of money.

Recently, a manager for a major firm in Southern California shared an experience she had overseeing a multiple offer in her office. The property had 26 offers. Of these, two of the offers had a 20 percent down, while another two had 10 percent down. The 22 other sets of buyers were seeking 100 percent loans, most of which were adjustable-rate mortgages. In addition, the majority of these buyers asked the seller to cover closing costs. Another good friend told me he's now writing only 40-year loans or interest-only loans. "Why pay more than you have to if you're only going to stay in the property a few years and then trade into something else?"

Prices are so high in some locations that people are stretching to come up with enough funds to purchase. Nevertheless, sooner or later the strong seller's market will turn into a buyer's market where prices decline and refinancing is suddenly out of the question because the owner has no equity. This wouldn't be the case if the buyer's agent had advised the buyers how taking a shorter-term loan quickly builds equity.

Assume you are purchasing a property and obtaining a \$200,000 loan and a 6 percent interest rate. Compare the following costs:

- 30 years, the monthly payment is \$1,199 per month.
- 40 years, the monthly payment is \$1,100 per month.

The difference is \$3 per day, the cost of a cup of Starbuck's or brown bagging your lunch twice a week rather than going out. Now compare the same loan amortized for 15 years.

- 15 years, the monthly payment is 1,688.

The difference between the 15- and 30-year loan is \$489 per month. This translates into \$16 per day and may not be in reach for many people. Nevertheless, for those who can make the stretch, it's worth it. Compare the amount of interest paid over the course of each loan.

- 30-year loan interest payments total \$231,676.
- 40-year loan interest payments total \$328,205.

That's over \$100,000 in interest savings for only a mere \$3 per day. The major savings come, however, from taking a 15-year loan.

- 15-year loan interest payments total \$103,788.

The owners who pay off their loan in 15 years instead of 40 save more than \$225,000 over the term of the loan. That's enough to buy an investment property or to dramatically increase the amount of money you will have when you retire.

Courtesy of George Fotion

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Many agents and buyers believe that if you're going to be moving in a few years, paying the minimum is a good strategy. In most cases, this is not the case, especially if there is a downturn in the market. Assume each of two owners sells his/her property at the end of year 6. The owner who financed his property for 30 years has approximately a 7 percent equity position, assuming there has been no increase in prices. If the owner has to sell or has an emergency, there is no equity on which to draw. In fact, with a 7 percent equity position, the owner would have to dip into his pocketbook to close the transaction.

Now compare the previous scenario with the owner who financed her home for 15 years. At the end of year six, she has a 28 percent equity position or approximately \$56,000. By taking a more aggressive loan, she has both flexibility and cash.

Equally disturbing is the number of people who are taking adjustable-rate mortgages (ARMs) with low teaser rates. If they can qualify, most people are better off with a fixed-rate mortgage. Rates are at all-time lows. Sooner or later they will increase. Owners who obtain a fixed-rate mortgage have locked in their payments for the next 15 or 30 years. This is better than renting because there is no payment increase. The challenge with ARMs is that your payments are not fixed. The borrower is betting his/her salary will keep pace with the increase in interest rates. Returning to our \$200,000 loan example, an increase from 6 percent to 8 percent means the borrower's payment will increase from \$1,199 per month to \$1,468. This is an increase of \$3,204 per year or \$90,000 over the life of a 30-year loan.

Make sure your existing loan or any loan you take does not have a prepayment penalty. Banks can extract up to six months of interest if the loan is paid off early. Check for this in both your existing loans and any future loans you may take.

I want to demonstrate to you my commitment as a strong customer experience expert. For more information on how to provide you a better real estate purchase or sale experience, call me or keep checking in to my website.

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