Escaping the 30-Year Mortgage Trap

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Raise your hand if you've ever taken out a 30-year mortgage.

C'mon. Get 'em up there. Nobody is looking, I promise.

OK, now keep your hands up if you feel like you've been duped.

It's true. And it's happened to me too. Here's how…

The Problem with a 30-Year Mortgage

A 30-year mortgage is one of the biggest financial traps around. It is also one of the most common, which is something that makes it even sneakier.

So, what's wrong with it? Well, a 30-year mortgage encourages home buyers to spend more than they can afford, borrow more than they should, and pay more in interest than is necessary. And, unless you're planning to stay in the home for a looooooong time, you're going to make minimal progress in building equity.

Look, I've done it too. When Holly and I bought our first house, we placed our trust in the well-known, much beloved 30-year fixed rate mortgage. With it, we were able to purchase a nice, small starter home in a decent neighborhood. More importantly, the 30-year fixed allowed us to make payments that we could easily afford.

Of course, this was a starter home. We bought it with the intention of moving to a larger place sometime in the near future. Unfortunately, we didn't quite understand why a 30-year mortgage wasn't our best option.

Like us, I suspect that most first-time home buyers – who are typically younger – aren't buying their dream home right off the bat. In fact, a study published in 2013 by the National Association of Home Builders estimates that a typical first-time home buyer will live in the home an average of 13 years.

See Also: House Shopping – The Addiction Continues

So, what's the problem?

The Biggest Reason to Avoid a 30-Year Mortgage

To understand how you're being trapped by a 30-year mortgage, you first need to understand how a mortgage works. When it comes to mortgages, interest is not spread evenly throughout the 30-years. Mortgage interest is amortized, meaning you pay more in interest on the front end of the process.

For example, if you take out a$150,000 30-year fixed rate mortgage at 4.5% interest, your monthly payments will total about $760 a month, not including taxes and insurance. Of that $760, about $560 of it goes toward interest for the year of your loan. On the flip side, less than $35 a month will be paid toward interest over the last year of the loan.

This means you are essentially renting the home from the bank for the first several years of the mortgage! Unless you stay in the home for an extended period of time, you're going to have trouble gaining any substantial equity in the home.

See Also: Why We Prepay Our Mortgage

Unlike renting, though, you also have to pay for any repairs or upgrades to the house. So, not only are you struggling to build equity. You're also on the hook for repairs.

As we already know, younger people and first-time home buyers tend to flock to the 30-year mortgage for their first loan. Because they grow comfortable with it, they'll more likely to stick with it for their next purchase as well.

But, what does it really cost you?

The Numbers

As an example, let's use some estimates on our current living situation. When we purchased our current house, we had a substantial down payment and the option to finance either a 30 or 15-year fixed mortgage. We chose the 15. You'll see why when you look at how the numbers break down:

15-year fixed at 2.75% interest – We could owe total of $33,225 in interest over 15 years.

30-year fixed at 3.75% interest – We would have paid a total of $100,082 in interest over 30 years.

Big difference, right? That's almost ***$70,000 of real money saved!***

Most importantly, after 10 years of ownership, we will have $93,000 in equity in our house, paying just $29,150 in interest. Had we selected the 30-year, we would have just $32,830 in equity and $50,894 paid in interest.

On the downside, our monthly payments are more expensive, but we'll look more at that in a minute.

See Also: Unison Review – How to Fund Half Your Down Payment Without a Loan

3 More Reasons 30-Year Mortgages Suck

Need more reason to avoid a 30-year mortgage. Here's a few:

1. **Longer Term** – Seriously, who the hell wants to be in debt for 30 freakin' years! Good LAWD! No thank you. This is *especially* true for people buying their second and third home. Why in the world would you still want a house payment in your 50s, 60s, or (gasp) 70s? Puke!
2. **Higher Interest Rates** – The longer you extend the term, the bigger the risk the bank takes on your loan. As such, you're going to pay a higher interest rate.
3. **Save Money on Interest** – Did I mention that you'll pay tens of thousands of dollars more in interest? Why that when you could purchase something you can afford in a 15-year term and this is such an easy way to save money?

How to Escape the 30-Year Trap

If you've already committed to a 30-year mortgage, you can still get out of it and save money. Here are a few ways to escape the 30-year mortgage trap.

- **Pay it Off in Cash**: Easier said than done, right? But, if you've got the cash to do it, pay it off. Get rid of it and be done!
- **Pay Extra on Your 30-Year Mortgage**: By making extra payments on your 30-year mortgage, you can effectively reduce the length of your term and decrease your interest payments. In our example, the monthly payments on the 15-year are about $1,017/month. On the 30-year, they run about $695/month. If you take the $322 you save and pay the extra toward your principal each month, you can pay off your 30-year mortgage in 16 years. Because your interest rate is still higher, you won't save as much as you would have if you started with 15-year loan. However, you'll still save about $49,000 in interest by going this route…and that's definitely not chump change! In fact, it's one of the **best investments** with low risk you can make.
- **Refinance to a 15-Year Mortgage**: We've done this with a couple of our properties, and it has saved us tens of thousands of dollars! Using our example above, **we saved almost $70,000 in interest** by going with the 15-year mortgage. That's real life money, people!!!

Where Can You Refinance?

LendingTree is a great place to search for the best refinancing rates. There, you can compare rates from several companies at once. That way, you know that you're getting the best deal available. **Compare rates for up to 5 lenders here!**

Wrapping Up

To build real wealth, you need to make smart money moves. Avoiding giant debt traps will put you far ahead of your peers. While they are schlepping away to pay off their house, you'll have left them in the dust years ago.

Remember, the quickest way to build your wealth is to destroy your debt. The faster you can get rid of it, the better off you'll be.

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About The Author

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Greg Johnson is a personal finance and frugal travel expert who leveraged his online business to quit his 9-5 job, spend more time with his family, and travel the world. With his wife Holly, Greg co-owns two websites – Club Thrifty and Travel Blue Book. The couple has also co-authored a book, Zero Down Your Debt: Reclaim Your Income and Build a Life You'll Love. Find him on Instagram, Facebook, and Twitter @ClubThrifty.

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