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Exotic Mortgage

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Summary:
With real estate prices ever on the rise, first-time home buyers are facing more difficulties in buying a home. Who ever thought they'd buy a $500,000 starter home?

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Article Body:
With real estate prices ever on the rise, first-time home buyers are facing more difficulties in buying a home. Who ever thought they'd buy a $500,000 starter home?

Mortgage lenders have acknowledged the problem by creating new and innovative mortgage products, mostly designed to lower the borrowers' payments in the first few years of the mortgage. Many of these products allow borrowers to buy homes that they traditionally couldn't afford, but they aren't without risk.

The latest and most exotic mortgages out there include:

1. The 40-Year Mortgage
2. The Portable Mortgage
3. The Interest-Only Mortgage
4. The Negative Amortization Mortgage
5. The Flex-ARM Mortgage
6. The Piggy Back Mortgage
7. 103s and 107s
8. Home Equity Line of Credit
9. Loan Modification Mortgage
10. Short-Term Hybrids

1. The 40-Year Mortgage

This is similar to a 30-year fixed rate mortgage, except the payment is being stretched over an extra 10 years. The lender will charge a slightly higher interest rate, as much as half a percentage point.

A 40-year mortgage gives you lower monthly payments than a 30-year loan, while allowing you to lock in today's interest rate. If you buy a $300,000 mortgage at a 6.25% interest rate, you could be saving $95 each month in payment.

But by extending the length of the mortgage, you are increasing the amount of interest paid on the loan. For a $300,000 mortgage, a home buyer will spend an additional $170,030 in interest with a 40-year mortgage.

These mortgages are best suited for first-time home owners who don't plan to live in the home for more than a few years. If they can't afford the higher payment of a 30-year mortgage, the 40-year may give a good start to home ownership.

2. The Portable Mortgage

E*Trade has a program called Mortgage on the Move. It allows a home buyer to lock in a low interest rate and then take the rate with them to their next home in a few years. A second mortgage can be used if the buyer needs to borrow more money for the new home.

When interest rates are low - and looking to rise - locking in a rate for the next 30 years is attractive.

But interest rates for portable and second mortgages are higher than for standard loans. You may be looking at paying ½ to ¾ a percentage point more than on a typical 30-year fixed-rate mortgage.

This product is good for those who know they will move in a few years, but still want to lock in a low rate.

3. The Interest-Only Mortgage

With an interest-only mortgage, the lender allows the borrower to pay only the interest for the first so many years of a mortgage. After the grace period, the loan essentially becomes a new mortgage with the interest and principal being stretched only the remaining years. For example, you may pay no principal for the first ten years, and then pay the principal and interest for 20 years.

This gives you a smaller monthly payment during the interest-only repayment period, and during this time, all the money being paid is tax deductible.

But if home prices don't rise, your equity won't build during the interest-only years. When your principal-payment period begins, the monthly payments will jump significantly. Most of these loans feature variable interest rate, which puts you at risk for even higher monthly obligations.

This type of mortgage is great if you know for sure that your income will rise significantly in the next few years. Interest-only loans are also a good fit for professionals who receive large bonuses as part of their pay. They can pay interest during most of the year and then put the bonus towards the principal.

4. The Negative Amortization Mortgage

This interest-only type of mortgage allows a buyer to pay less than the full amount of interest. The difference between the full interest payment and the amount actually paid is added to the balance of the loan.

This gives you the option of a much smaller monthly payment during the first years of a loan.

But, this is probably the most risky mortgage available. If the value of your home falls, you will easily be upside down in your load. You would owe more money on the house than it is worth.

These loans are great for those with large cash reserves who need to make lower payments during certain parts of the year, but can pay off the difference in large chunks at other times.

5. The Flex-ARM Mortgage

This is a cross between a hybrid ARM, which offers a low fixed interest rate for the first five to seven years and then adjusts annually, and a negative amortization loan. Each month you receive a coupon that gives you four possible payment options: negative amortization, interest-only payment, 30-year fixed and 20-year fixed. The homeowner decides how much he wants to pay.

The bank handles all of the calculations for you. But if not used wisely, you could owe more on your mortgage than your home is worth.

A Flex-ARM is good for those who prefer to have options. The borrower should have large cash reserves for when the mortgage payments enter the later part of the loan. Like interest-only loans, they are great for those who receive bonuses during the year.

6. The Piggy-back Mortgage

This is actually two mortgages, one on top of the other. The first mortgage covers 80% of the property's value. The second covers the remaining balance at a slightly higher interest rate.

In most cases, borrowers choose a piggy-back mortgage because it allows them to put less than 20% down and still avoid paying private mortgage insurance. The money that would be used towards private mortgage insurance is now tax deductible as interest paid.

Homeowners should expect to pay a higher interest rate on a second mortgage. The rates you pay vary greatly depending on your credit score. Since the borrower has very little equity in the home, there is the fear of the home losing value and the borrower owing more than they can sell it for.

Piggy-back mortgages are a good fit for young professionals with reasonably high salaries, but no savings.

7. 103s and 107s

You may not need to save for a down payment at all. You could borrow 3% or 7% more than your home is even worth.

These loans give you the option of borrowing money needed for closing costs and moving costs. You can include it all in the mortgage.

The interest rates for these mortgages are high. You run the risk of negative equity if your home loses value.

If you have large cash reserves that work better for you in the stock market than in investing in your home, you may want to look at this type of mortgage.

8. Home Equity Line of Credit

These aren't just for those who own a home! They are commonly known as HELOCs, and they can finance an original home purchase using a credit line instead of a traditional mortgage. HELOCs are variable-rate mortgages tied to the prime rate. If you use this mortgage as your first mortgage, all of the interest is tax deductible. You simply make a down payment, and the HELOC pays the remainder. You can usually use one for up to 90% of the home's appraisal value. For a higher interest rate, you may qualify for 100%.

HELOCs can offer more attractive interest rates. You can also use the equity you build in your home at any time.

HELOCs are usually structured for 10 to 20 years, instead of 30. The interest rate is variable, which means that your payment can rise at any time.

If you want to pay off your home quickly, but need the ability to access your equity at any time, you might consider a HELOC as your primary mortgage.

9. Loan Modification Mortgage

This mortgage allows you to change your terms whenever you want, all you have to pay is a $1,000 closing cost for every million dollars borrowed. No paperwork is necessary; all you have to do is make a phone call.

You can expect to pay about 3/8th of a percentage point higher interest rate.

People who like to follow interest rates can call and have their rate changed when interest rates are down. But borrower's must take into consideration the closing fees charged each time they modify their mortgage. Many customers with this type of mortgage have financial planners who manage the mortgage.

10. Short-Term Hybrids

These mortgages are much like traditional hybrid ARMs with fixed-rate periods and then interest rate that floats. But the fixed portion on a short-term hybrid is for a very limited time, for example, six months to a year. Lenders offer very competitive rates on these mortgages.

The interest rates are very low for the fixed portion of the loan, making the initial monthly payments relatively small.

But six months or a year is not a very long period of time, but rates can change dramatically in just that amount of time.

People who plan to flip a house or move in a very short period of time are good candidates for a short-term hybrid ARM.