



Types of Mortgages

Over the past decade, financial service providers have developed a wide array of new products and services to help people buy homes. And, while innovative products can help some people, they can spell disaster for others.

This sheet offers a brief overview of popular products on the market. It is not designed to be comprehensive nor does it take into account the vast differences among lenders. Rather, it should provide you with a general sense of each product and a starting point for your own research.

Fixed Rate Mortgage

The most common type of residential home loan, it is repaid through equal monthly payments over a specific period of time – usually 15 or 30 years. In most cases, payments early in the loan go mostly toward interest while later payments are applied mostly to principal.

Adjustable Rate Mortgage

Often referred to as an ARM, the interest rate of this mortgage can change over time. Most ARM's start with a lower, fixed rate for the first 3-10 years. After that, the interest rate becomes adjustable and can rise. How much it can change depends on several factors. Borrowers should be careful to fully understand the terms.

Interest Only Mortgage

During an interest only mortgage, a borrower repays only interest owed on the loan for a period of time, usually five to seven years. After that, payments go up, sometimes significantly, to include principal. The initially lower monthly payments allow some people to qualify for larger loans.

Piggy Back Mortgage

Also known as blended mortgages, 80/20 mortgages, or 80/10/10 mortgages, piggy back mortgages are really two different mortgages made at the same time. The purpose is to allow the homebuyer to buy a home with less than a 20% down payment but avoid paying for private mortgage insurance (PMI). Typically, a first mortgage is made for 80% of the purchase price. After that, any downpayment is applied and a second mortgage is taken out for the un-financed amount that remains.

103% or 107% Mortgage

So called "100+" mortgages allow homebuyers to close their loans without having any up-front cash. The loans cover 100% of the cost or appraised value of the home as well as provide the borrower with an additional 3% or 7% in cash. The extra amount can be used to pay closing costs and is included in the loan's principal. These loans typically have higher interest rates and require PMI.

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FHA Mortgage

The Federal Housing Authority (part of the U.S. Department of Housing and Urban Development) insures mortgages that typically have lower down payments, lower closing costs, and somewhat easier qualifying criteria than conventional loans. Maximum loan amounts are determined by the median prices of homes in different cities within specific regions. In the past few years, FHA loans have become less bureaucratic for lenders, realtors, and others.

VA Mortgage

The U.S. Department of Veterans Affairs guarantees mortgage loans to active members of the military and veterans. The VA doesn't make the loans itself, but provides its backing to private lenders. This generally allows qualified borrowers to get better terms on their mortgages.

Reverse Mortgage

A reverse mortgage allows older homeowners to withdraw equity from their homes. The money doesn't have to be paid back until the borrower dies, sells the home, or permanently moves out. To be eligible for most reverse mortgages, a borrower must be at least 62 years old and already own the home.

Mortgage Refinancing

Refinancing occurs when a borrower takes out one mortgage to pay off another mortgage. Most borrowers refinance to secure a lower or less variable interest rate than they currently have. In some cases—based on the value of the home—borrowers can get more money than is needed to pay off the existing mortgage. The additional money can be used to improve the home, finance a major purchase (like a college education), or pay off other debt.

Home Equity Products

Home equity loans, also known as second mortgages, come in a lump sum. Borrowers repay monthly based on the terms of the loan (fixed, ARM, etc.). Home equity lines of credit, on the other hand, work like credit cards. Instead of getting a lump sum, borrowers start out with a credit line and can draw up to its limit. During the first years of the account, the minimum monthly payment covers only the interest on the balance. The rate is usually variable and tied to the prime rate. In both cases, interest is usually deductible from federal income taxes.