Mortgage menu requires study

For some, selecting a mortgage is as mysterious and as infuriating a process as trying to keep track of the pea in a shell game. How do you know which one is right for you?

According to the Farmington Hills-based Michigan Association of CPAs, the key to choosing a mortgage is taking the time to understand how mortgages differ. In most cases, you will have to decide between a fixed- or adjustable-rate mortgage.

Fixed-rate mortgages feature monthly payments that remain the same over the life of the mortgage — usually ranging from 15 to 30 years. At the start of the loan, the payment goes almost entirely toward interest, which is tax deductible. In time, a greater percentage of the monthly payments will go toward the principal, thus increasing your equity in the property.

The primary advantage of a fixed-rate mortgage is its predictability. If your monthly payment is $1,000 today. It will be $1,000 20 years from now, and in 20 years, $1,000 will seem a lot less than it does today. The cost of this financial security is usually an interest rate that is two or more percentage points higher than those available on variable or adjustable loans.

When you apply for a fixed-rate mortgage, you generally have to decide between a 15- or 30-year term. Spreading the mortgage over 30 years means smaller monthly payments, which may enable you to qualify for a somewhat higher mortgage. As a general rule, the payments on a 30-year loan with an interest rate of 10 percent will be about 20 percent less than those on an equivalent 15-year loan. But if you can afford the higher payments on a 15-year mortgage, you can save a dramatic amount in interest costs and you will own your own home, free and clear, in 15 years.

WHETHER A SHORTER- or longer-term mortgage is preferable depends entirely on an individual's particular goals and finances. For example, a young professional who plans to sell her home within a relatively short time should probably opt for a loan that demands smaller monthly payments. A couple in their 40s or 50s who want a mortgage free home for their retirement years should seriously investigate the advantages of a short-term mortgage.

Some CPAs argue that disciplined investors may be able to equal or exceed the amount of interest saved on a 15-year loan by intelligently investing the amount saved each month under a 30-year loan. Also, because a larger proportion of the payments on a 30-year mortgage go toward interest, the tax benefit of such loans is much greater.

In the first months of 1989, adjustable-rate mortgages (ARMs), accounted for approximately 60 percent of all new mortgages. The reason for the popularity of these mortgages is easy to understand. ARMs have an initial interest rate that is two to three percentage points lower than those on fixed-rate mortgages. Over the life of the loan, the interest rate periodically increases or decreases based upon a particular index selected by the lender. In most cases, ARMs are indexed to either one-year Treasury Bills or to the prime rate.

BEFORE YOU CHOOSE an ARM, do a fair amount of comparison shopping. Pay particular attention to the caps or limits on how high the interest rate can climb. Most lenders limit the annual adjustment to one or two percentage points, with the total interest rate guaranteed not to increase more than five or six points over the life of the loan.

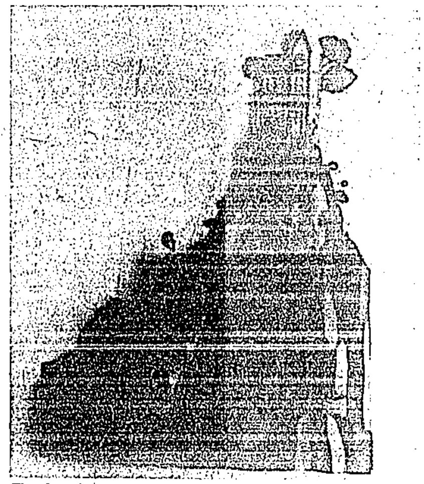
ARMs are particularly attractive to those who are confident that interest rates will decline or that their own salaries will increase substantially over time. These people choose ARMs because the monthly payments are initially lower than those they could obtain through other means. For example, the monthly payment on a $100,000, 30-year fixed-rate mortgage at 10½ percent is $915. On an ARM with an interest rate of 7½ percent, the monthly payment is about $700. Theoretically, as the ARM's interest rates and monthly payments increase over time, so should the mortgage holder's income.

But a problem could arise if inflation and market conditions cause the adjustable interest rate to increase at a much faster pace than the mortgage holder's salary. Here's an example, A few years ago, a couple had the choice between two types of mortgages: a one-year adjustable mortgage at 7.5 percent with a two-percentage cap per year and a lifetime cap of six points, or a 30-year fixed rate mortgage at 10½ percent. Because they expected a large salary increase, they opted for the one-year ARM. After two years, the ARM's interest rate rose to 11.5 percent. At the same time, the salary increase never materialized, and the couple ended up with higher monthly payments than they would have had under the fixed-rate mortgage — and without the substantial increase in income they had expected.

Still, ARMs can make sense for certain people. For example, if you expect to own your home for only a few years, an ARM can save you a bundle in interest charges. In such cases, you should consider three-, five- or six-year ARMs. The adjustable rates will kick in only after the stated period and until that time your interest will remain fixed at a rate usually a point or so lower than that on a conventional fixed mortgage.

Another option is the convertible ARM. With these mortgages, you can convert an adjustable-rate loan to a fixed-rate loan, usually during the second through fifth year of the loan. Just keep in mind that converting an ARM may sometimes cost as much as simply refinancing the loan.

Before you make a final decision on a mortgage, gather as much information as you can. The Federal Reserve Board requires lenders to supply customers with a 25-page booklet called the "Consumer Handbook on Adjustable Rate Mortgages."



The American dream of buying a home starts with weaving your way through the mortgage maze.

Seminar scheduled for would-be home buyers

Looking to become a homeowner soon but still in the dark over points, title insurance and the other technical aspects of real estate transactions?

The Western Wayne Oakland County Board of Realtors will sponsor a free home buying seminar at 7 p.m. Tuesday at the Holiday Inn Livonia West, 17123 Laurel Park Drive at Six Mile and I-275.

"This will be an informational, not a selling, session in which we'll have experts discussing all the steps involved from saving for the downpayment to closing," said Eric J. Hunt, president of the board.

"The sessions are not restricted to first-time buyers. Anyone planning a move can gain new insight into the home buying process from the financial, legal and real estate information to be presented.

"With home ownership the largest investment ever made by the average American, we think it important that they be properly prepared to examine the many alternatives facing them in today's residential market."

The seminar is expected to last about two hours and will include a question-and-answer period. Advance reservations are necessary by calling 478-1700. A similar seminar held by the board earlier in the year drew more than 500 persons.

The seminars are conducted as part of the board's public service programs, which currently include a food drive through the Salvation Army. Those attending he seminar are asked to bring one canned good to be added to those collected by board member offices within the last two weeks.