01/04/2007

The Facts About the 40-year Home Loan

You have probably heard about 30-year fixed rate loans and even 15-year fixed rate loans, but did you know there are 40-year fixed rate home loans available these days? In these times of decreased housing affordability in many parts of the country, some lenders have developed 40-year loan programs to help buyers get into a home. Even Fannie Mae, one of the nation's largest mortgage financers, has decided to start selling these long-term loans.

Yet, just because the program is becoming standardized does not mean that it is without its risks. Just what is a 40-year fixed rate loan and what are the benefits it offers? What are the disadvantages?

The Benefits

A 40-year loan is basically self-explanatory. The money you borrow for a home purchase will be amortized over the course of 40 years instead of the traditional loan term of 30 years. One of the main benefits of taking on a longer loan is that borrowers can get away with a smaller down payment.

The other main benefit is ability to make smaller monthly payments than you would have to make with a 30-year loan, and you do not have to assume as much risk as you would with an adjustable rate mortgage.

The Disadvantages

Unfortunately, the monthly savings between a 40-year and a 30-year loan are really not all that dramatic. Say, for example, that you take out a $200,000 at 6%. With a 30-year loan your monthly payment would be $1,199.10 and the total amount of interest you'd pay over the course of the loan would be $231,676. With a 40-year loan, your monthly payment would be $1.100.43. That is less than one hundred dollars in savings each month! Plus the total amount of interest you would end up paying would be $96,530.40 more than with the 30-year loan.

The situation may not even be that rosy. You will usually have to settle for a slightly higher rate on a 40-year loan because of the added risk to the lender. Generally, rates for 40-year loans are a quarter to a half point higher than the rates for 30-year home loans. So if you took out a 40-year $200,000 loan at 6.25%, your monthly payment would be $1,135.48, dropping your monthly savings to $63.62. It is hard to believe that minimal amount of savings is worth the extra ten years of mortgage payments and interest.

You should also realize that the equity-building process will be much slower with a 40-year loan, than with a 30-year mortgage. After ten years of making mortgage payments, the difference in equity between a 30-year and a 40-year mortgage could be as much as $20,000. That could make a big difference if you hope to take out a home equity loan down the line.

While it is true that you could refinance out of a 40-year loan after you can afford higher payments, the interest and closing costs could be prohibitive. If you are looking for low initial payments, you may be simply better off with an adjustable rate mortgage. Be sure to talk with your mortgage professional before deciding that the 40-year loan is the right mortgage for you.