Financing Your Mortgage with a Graduated Payment Mortgages

If you are trying to figure out the best mortgage financing option for your situation, you have probably encountered the traditional fixed-rate and adjustable rate mortgages. Fixed-rate loans let you lock in a certain interest rate from the beginning and have the stability of a constant payment amount until the end of your loan. Adjustable rate mortgages (ARMs) let you have a low fixed rate for an initial period, after which your rate will adjust periodically according to market trends. There are great benefits to both of these loan types and that is why you should look at a Graduated Payment Mortgage (GPM), a loan combination of both fixed and adjustable rates.

A Graduated Payment Mortgage still allows you that nice low payment at the beginning of your loan, and then provides that your payment will gradually increase over the next several years. The payment adjustment may last anywhere from 5-10 depending on your preference and your lender’s rules. If you have a payment that gradually increases for 10 years though, your initial payments will be lower than if your payments only increase for 5 years.

The nice thing about this type of financing is that it allows you more buying power than you would have with a strictly fixed-rate loan. Because your initial payments will be so low, perhaps even a couple hundred less than fixed-rate payments, you can qualify easier for bigger loans.

Of course this is only a good idea if you think you can afford both the initial and the gradually increased payments. This type of loan usually makes the most sense for younger homebuyers who anticipate an increase in their salary or income over the next several years. While this typically happens to a degree for everyone, simply due to inflation, expected raises or promotion can give you that added boost you’ll need to make further payments. You should be careful in making a decision on a GPM loan though, because if your income does not increase and you cannot afford the higher payments, you may lose your house.

Another great benefit of the GPM loan is that you do not have the same risk factor as you do with a normal ARM. From the very beginning of the loan, you know exactly what your payments will be at each stage of your loan. The payments will increase, but at least you will expect the jump and hopefully will be able to adjust your budget accordingly.

There are still risks associated with a GPM loan though. Your payments at the start of the loan will be so low that you will not actually be paying the full amount of interest due. The rest of the unpaid interest is tacked onto the principal of your loan and the total balance will actually grow for a while. This situation is called negative amortization because you are making payments but your contributions are actually increasing the loan balance. You will have to make up for this later in the loan by making much larger payments and paying off the principal at a much faster rate.

One risk is that if you need to sell your home within the first few years you might actually have to sell at a loss. Because of the negative amortization, you will owe more on your loan than you can sell your house for at market value. So before you get into a GPM, you should consider how long you’ll be able to stay in the home.

Because there will probably be several years of negative amortization, your lender will also take on a greater risk. If you foreclose anytime during those years, he will also have to sell your home at a loss, and will lose money on his investment. For this reason, lenders will charge you higher rates on GPM loans than on other financing options.

Talk to your trusted lender about a graduated payment loan. She will be able to help you figure out if the terms will be a good fit for your situation. Make sure you consider all the benefits and disadvantages before signing. A graduated payment loan may be the key to getting you into the perfect home!