Interest-Only Mortgage: Right For You?

(NAPSA)—As home prices continue to rise and speculation persists regarding higher interest rates, you may be hearing a lot of buzz about one of the mortgage industry's most popular products—interest-only (IO) loans. IO loans allow homebuyers to lower their monthly payments for a set period of time—and now make up 50 percent of the total share of mortgages in major competitive housing markets like San Diego, Atlanta and San Francisco.

Before you jump on the IO bandwagon, it's important to determine if, in fact, it is the right loan for you. While IO loans can help you afford the home of your dreams, consumer advocates advise buyers to proceed with caution and fully understand how the product works.

With an interest-only mortgage loan, you pay only the interest on the mortgage in monthly payments for a fixed term, freeing up the amount that would normally go toward paying off the principal for other purposes. At the end of the interest-only period (typically two to 10 years), your loan reverts back into a more typical mortgage, with the monthly payments adjusted upward (as much as 50 percent or more) to include interest and principal for the remaining years of the loan.

IO loans present a terrific option for the right borrower. They work best for those who manage their money well, consistently pay down their principal balance and have disciplined spending and saving habits. Even for sub-prime borrowers, an IO loan can be a feasible choice as long as you are a good money manager and are disciplined in your spending and saving habits.

An interest-only mortgage loan offers lower payments early on, but requires financial discipline.

IO loans are not for everyone because they require a high level of financial discipline. They can also entail more risk for the borrower and the lender than other products. They may not be well-suited, for example, for first-time home buyers; if the only way you can qualify for a home is through an IO loan, it's probably not the best solution. A good rule of thumb is that if you just want to use the lower payment of an IO loan solely to afford a more expensive home, then you should reconsider your options.

"Borrowers sometimes have a tendency to be blinded by the lower payments of an interest-only loan," says John Palmiotto, senior vice president for Opteum Financial Services, one of the nation's fastest growing mortgage lenders. "However they should really understand what can happen with that loan when rates rise and the likelihood they will. Your mortgage lender should explain the interest-only product in as much detail as possible to see if it's right for you."