

The Total Cost of a Home Mortgage

Buying a home is a major event in our lives, and the excitement can easily overshadow the long-term financial commitment we're about to make. This is especially true when we've found a home that we love. The property taxes, maintenance, and mortgage obligation that we're committing to, often take a backseat to the excitement of buying a home. We tend to see a mortgage much like a car loan and focus on the monthly payment, while overlooking the cost of the loan or total amount of interest that will be paid over the life of the mortgage.

There are several different kinds of mortgages. The most popular are fixed rate (the interest rate never changes) and ARMs or adjustable rate mortgages (the interest rate fluctuates according to a set criteria). There are also interest-only mortgages (the payment is only interest, the loan is never paid off) and graduated and balloon payment mortgages (the payments rise over time).

One of the greatest costs associated with a mortgage is interest. In the case of a mortgage with a changing interest rate, we can't calculate the total amount of interest that will be paid. For a fixed rate mortgage, we know the interest rate is fixed, so we can calculate the interest over the entire period of the loan. This allows us to calculate the total interest over the life of the loan (mortgage).

As an example, we'll assume that we're buying a house with a \$275,000 purchase price. Our down payment will be \$25,000, so we'll be financing \$250,000 through a mortgage company or bank with a fixed rate mortgage. We'll assume that the loan is for thirty years, which is the standard mortgage duration, and we'll review the effects of different interest rates.

Home price	\$275,000
Down payment	\$25,000
Mortgage amount	\$250,000

The table below shows the monthly payment, total interest paid over the life of the mortgage, and the total payback amount, using various interest rates (left-hand column). In the "total interest paid" column, we see the cost of the loan. This is the amount in interest that will be paid over the 30 year period. Now consider the "total payback amount" column to the right. This is the original mortgage amount plus the interest from the "Total Interest Paid" column. Notice how the total payback amount compares to the amount being borrowed. In the bottom row of the table, at a 6% interest rate, the interest paid is more than the mortgage amount and higher than the original price

of the house, and the total payback amount is more than twice the price of the home. This should get our attention.

Mortgage Analysis \$250,000, for 30 Years, at Various Interest Rates

<u>Interest Rate</u>	<u>Monthly Payment</u>	<u>Total Interest Paid</u>	<u>Total Payback Amount</u>
3.5%	\$1,122.61	\$154,140.23	\$404,140.23
4.0%	\$1,193.54	\$179,673.78	\$429,673.78
4.5%	\$1,266.71	\$206,016.77	\$456,016.77
5.0%	\$1,342.05	\$233,139.44	\$483,139.44
5.5%	\$1,419.47	\$261,010.10	\$511,010.10
6.0%	\$1,498.88	\$289,595.48	\$539,595.48

In the past, mortgage lenders would carefully scrutinize our finances to ensure that we were able to make the monthly payments based on income and debt. They also required a down payment that was at least 20% of the appraised value of the house (in some cases more). These guidelines were reduced prior to the housing market crisis and lenders were approving mortgages for borrowers who were making 5% down payments or even no down payments at all. Although guidelines for borrowing were increased after the crisis, they have begun to ease again to promote economic growth and improve the housing market.

We should perform our own analysis and make our own financial decisions based on our financial plans and goals. Simply because a lender will loan us the money doesn't mean that it's in our best interest to borrow.

We should also carefully assess both the monthly payment and the total cost of the mortgage based on available interest rates. Buying a home is an exciting and rewarding event in our lives, but with a long-term loan like a mortgage, we should consider much more than the monthly payment.

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