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Important Facts About Interest-Only and Payment Option Mortgages

Whether you are buying a house or refinancing your mortgage, this information can help you decide if an interest-only mortgage or a payment option mortgage is right for you. These mortgages can be complicated. If you do not understand how they work, you should not sign any loan contracts, and you might want to consider other types of loans.

Interest-Only Mortgages allow you to pay only the interest on the money you borrowed for the first few years of the mortgage (the “interest-only period”).

If you pay only the amount due, then at the end of the interest-only period:

- You will still owe the original amount you borrowed.
- Your monthly payment will increase because you must pay back the principal as well as interest. Your payment could increase even more if you have an adjustable rate mortgage (“ARM”) and interest rates increase.

Payment Option Mortgages allow you to choose among several payment options each month during the first few years of the loan (the “option period”). The option period will end earlier than scheduled if the amount you owe grows beyond a set limit—for example, 110% or 125% of your original mortgage amount.

During the option period, the payment options usually include:

- A payment of principal and interest, which reduces the amount you owe over time.
- An interest-only payment, which does not reduce the amount you owe.
- A minimum payment, which may be less than the interest due that month. *If you choose this option, any unpaid interest will increase the amount you owe.*

At the end of the option period, depending on what payment options you chose:

- You could owe substantially more than the original amount you borrowed.
- Your monthly payment could increase significantly because:
 - You may have to start paying back principal, as well as interest.
 - Unpaid interest may have increased the amount you owe.
 - Interest rates may have increased (if you have an ARM).

Additional Information

► **Home Equity**—If you make interest-only payments, your payments are not building home equity. And, if you make only the minimum payment on a payment option mortgage, you may be losing home equity. This may make it harder to refinance your mortgage or to obtain funds from selling or refinancing your home.

► **Prepayment Penalties**—Some mortgages require you to pay a lump-sum prepayment penalty if you sell your home or refinance during the first few years of the loan. You should find out if your mortgage has a prepayment penalty, how it works, and how much it could be.

► **No Doc/Low Doc Loans**—“Reduced documentation” or “stated income” loans usually have higher interest rates or other costs compared to “full documentation” loans that require you to verify your income and assets.