

## 40 year Home Loans?

When it comes to applying for home loans, buyers now have options other than the traditional 15 and 30 year home mortgages with 40, and in some cases, 50 year home loans being offered.

The 30-year fixed-rate mortgage may still be the most common home loan in the country, but 40 year loans are picking up speed, accounting for 5 percent of all new mortgages in the United States, and 50 year loans are not far behind. But are they the most economical options for homeowners? While extending the period of the loan would seem to benefit the borrower, Dr. Harold Hunt of the Real Estate Center at Texas A&M University said that is not necessarily the case.

“The 40-year and 50-year loans have provided minimal affordability relief to homeowners in markets outside Texas,” Hunt said. “A significant number of these borrowers have originated interest-only loans or “exotic” loans that can actually increase loan balances. These loans offer little advantage to Texas borrowers and should be viewed with skepticism by anyone intending to keep a mortgage ten years or less.”

Known as “hybrid ARM” loans, 40 and 50 year loans begin as fixed rate mortgages but are converted to an adjustable rate mortgage (ARM) after a specified term. For most 50 year loans, this happens five to ten years after the loan is made. In theory, this increase is intended to compensate for the lender’s money being tied up for a longer time, assuming the loan matures. In reality, the mortgage is usually refinanced or paid off when the home is sold, well before loan maturity.

Although the amount of interest paid over ten years or less is not appreciably different, the difference can add up with 40 and 50 year loans, making them substantially less effective than a 30 year loan at reducing an outstanding balance. On top of that, Hunt said they do little to lower monthly mortgage payments. “For a \$100,000 loan, the largest reduction in monthly payments would be about \$33,” he said.

Hunt said 40 year and 50 year loans make even less sense if a borrower intends to retain the mortgage more than ten years. A 30 year loan’s interest rate is locked in over the whole 30 year term while the 40 and 50 year loans must eventually convert to an ARM. “This exposes the borrower to the risk of future payment increases should interest rates rise above the level they were when the loan was originated,” Hunt said. “Considering today’s historically low interest rates, that risk is not insignificant.”

*Source: Texas Real Estate Center - The Real Estate Center has been providing solutions through research for 35 years. Funded primarily by Texas real estate licensee fees, the Center was created by the state legislature to meet the needs of many audiences, including the real estate industry, instructors, researchers and the general public.*

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