

The Benefits of the 15 Year Loan

Recently people have been interested in a lot of the more exotic loan programs from no interest loans to negative amortization. There has been some negatives associated with these loans with the changes in the mortgage industry. So I wanted to take some time to talk about the almost forgotten 15 year loan. Some people see the 15 year loan as drab and boring compared to all the fancy loans out there, but there are a lot of benefits of the 15 year fixed-rate loan.

For one, you pay the loan off in half the amount of time you would with a 30 year loan. So if someone is currently 30 years old, they would pay off the loan when they are 45 instead of 60. Because it takes half the time, people frequently think that the payment on a 15 year loan is twice as much as on a 30 year loan, but this is far from the case. For instance, if we look at Compass Bank today a 30 year \$160,000 loan will have a monthly payment of \$1037.75. On the other hand, a 15 year loan is \$1382.80 a month.

This shorter loan life translates to paying significantly less interest over the life of the loan. To figure out the interest, we take the total payments per year over the life of the loan and subtract the original amount of the loan which is 160k. So for the 30 year loan we use the formula $(\$1037.75 * 12 * 30\text{yr}) - \$160,000 = \$213,590$. So you are pay a total of \$213,590 in interest over the 30 years. On the other hand, for a 15 year loan using the same formula $(\$1382.80 * 12 * 15\text{yr}) - \$160,000 = \$88,904$, you end up paying only \$88,904 in interest, which is a 59 for a 15 year and 6.75% for a 30 year.

Are there any downsides to a 15 year loan? The biggest is probably inflation. If we went through a period of rapid inflation then for the last 15 years of the loan the payments would effectively be less because of inflation.

I am not saying everyone should get a 15 year loan. Frequently, people cannot spare the extra money per month and need to put that money into getting a larger house because of children or other needs. And I would never expect a 15 year loan to be the most prevalent mortgage used. But before picking a mortgage, it's probably a wise move to consider the 15 year mortgage and weight out its advantages.

Source: <http://www.articlecircle.com>

About the Author

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