00;00;07;27 - 00;00;28;02

Andrew Baron

Welcome, listeners, I am your host, Andrew Baron, and this is well, it depends. And in this episode, we ask the question “Should I have a 30 year mortgage?” Well… it depends is the podcast where we present the pros and cons of financial decisions so that you, the audience, feel more informed and confident in your choices.

00;00;28;18 - 00;00;49;10

Andrew Baron

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Andrew Baron

And before we begin our discussion on mortgages, a short disclaimer. The contents of this podcast are strictly for informational purposes only, and nothing said should be taken as investment, tax or legal advice. Any strategies discussed may not be suitable for listeners specifically, and so we strongly encourage consulting with your advisor before implementing any strategies to ensure they meet your individual objectives. In this episode, to help me answer the question, should I have a 30 year mortgage, we have William Post, who used to be a lending officer for a number of years and had experience helping clients obtain mortgages.

00;01;32;22 - 00;01;33;13

Andrew Baron

Welcome, William.

00;01;34;07 - 00;01;37;02

William Post

Thanks for having me, Andrew. Looking forward to this discussion.

00;01;37;26 - 00;01;55;12

Andrew Baron

Approaching this question, since it is a point of debate on the terms, the 30 year mortgage versus a shorter term, compared to a 15 year mortgage, let's have William start us off by comparing the hard and soft approaches of this topic.

00;01;57;02 - 00;02;11;10

William Post

Absolutely, Andrew, so when I would work with either present clients or past customers of mine, they would always pose the question ‘What is the right term for me?’ Just like the titling of this podcast, well, it depends. It's the truth.

00;02;11;10 - 00;02;35;01

William Post

It depends. We have to understand what's all involved with this conversation. I liken it to how individuals have soft and hard skills. Soft skills are the more people and life skills, hard skills are the technical skills. So when discussing mortgages, you have the hard information, that's the math behind it, which we'll discuss in just a second

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William Post

And then the other part of it is the life part of it. And they don't always communicate on the same line. And depending on where you're at, will tip the scales as to whether or not we should make a mathematical decision or a life decision.

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William Post

On the math side, typically, when you go for a loan of any type, the longer the loan term, the higher the interest rate. Simply because the bank is accepting more risk over a longer period of time and they want to collect that risk based and they do that through higher interest rates.

00;03;08;23 - 00;03;30;29

William Post

The inverse is true as well. The shorter the term, the lesser the interest rate. What makes this conversation so interesting? As of late, you don't see a huge difference in that gap. So as of today, a 15

year mortgage, somewhere between 3.3% and pushing 4% where anything above that 15, so you're going 15 to 30 year,

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William Post

that interest rate is right at around 3.9 to low 4's, depending on the day. Well, this makes for a very interesting conversation because previously there is usually a much larger gap in interest rates, where a 15 year loan was substantially less than a 30 year loan.

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William Post

Well now the interest rates are, for all practical purposes, rather flat. So it's changed the whole dynamic of this conversation, specifically the math behind it. An observation that I have made is a 20 year mortgage, basically the same rate as a 30 year mortgage.

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William Post

Normally, the rates drop off in blocks of five, well that hasn't been the case recently. So if you're having the discussion whether I should take a 20 year loan versus a 30 year loan, well, interest rate has been an almost zero factor in that conversation.

00;04;26;15 - 00;04;40;18

William Post

It's been mostly budget focused because there isn't an interest rate benefit in that scenario. And really, you could almost have the same argument by today's standards because a 15 year loan is only at about 3.3 and a 30 year is at about 3.9.

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William Post

There's not a huge gap of a difference there, which leaves room for a lot of discussion.

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Andrew Baron

I guess I'd like to start getting into the comparison point of it. So if we look at it under the microscope of how much is the loan going to cost, the 30 year mortgage over the lifetime of the loan costs substantially more than the 15 year mortgage.

00;05;06;02 - 00;05;25;02

Andrew Baron

However, we as planners actually like to look at the bigger picture, not just the loan. So the piece that's missing from the equation is what we call the opportunity cost. So the 15 year mortgage is going to have double the premium cost essentially than the 30 year is.

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Andrew Baron

And if your interest rate difference are low, like we are in this current environment, you're maybe guaranteeing yourself a 3% rate of return versus taking the risk and investing in stock market and potentially outperforming that.

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William Post

So I actually did the math on that, Andrew. So that's a great segue. If you were to take a 100,000 dollar mortgage and do a 20 year loan versus a 30 year loan analysis, I did some of those numbers for us.

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William Post

This is based off of a 20 year rate at 3.5 and a 30 year rate at 3.9. So there's a marginal difference there, a marginal benefit. When you do the math, as for the monthly payment, the 30 year monthly payment is $471, and the monthly payment for the 20 year loan is $580, which is 109 dollar difference

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William Post

And again, this is on a $100,000 loan. Over the lifetime of those two loans, you're going to pay about $30,000 extra in interest for the 30 year loan. Sounds like a lot of money, right? $30,000 is real money, especially when comparing it to $100,000 principle - 30%, whatever the total loan difference.

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Andrew Baron

Yeah.

00;06;41;14 - 00;07;02;02

William Post

Right. Exactly. Yeah, that's typically how it works. But if you're to take that $109 difference over 20 years and invest it in the market and only earn 5%, which is not hard to do at the moment. You're going to make that.

00;07;02;22 - 00;07;22;06

William Post

Yeah. Correct, correct. I picked the low number. You're going to make $45,000 over that 20 years, and that's assuming you start that investment account, $109, and you make $109 monthly payments to it. So even just right there, yes, the 30 year mortgage costs more in interest.

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William Post

But if you were to reallocate those dollars and put it into an investment vehicle of any type earning 5% over that 20 year window. Net positive $15,000 and that's just on the simple math portion of it. Never mind talking about how inflation plays into this, how the housing price index plays into this, how the US dollar plays into this. Those are other parts of the conversation that I feel like we have to have outside of just the transactional numbers of doing a loan versus investing the dollars.

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Andrew Baron

The other thing I like to think about is no one says you're trapped into only making the minimum payments if you chose that 30 year loan. Right? Many times they let you pay additional principal or another trick that you hear about is paying every two weeks.

00;08;15;13 - 00;08;29;03

Andrew Baron

So over the course of a year, you actually will at 13 full payments then instead of just twelve. So that's another way you can kind of accelerate your mortgage without really putting too much difference than you are already planning on it.

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William Post

Yeah, that's, that's an excellent point, Andrew. I would frequently tell individuals that especially with the interest rates, the way they are again, there's not a big difference between the shorter term mortgage rates and the longer term mortgage rates.

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William Post

Once you put a note together, you're bound to that note. You can always pay extra. You can't pay less than the terms of that note. If you want to tackle this in 20 years, awesome. Let's put together a 30 year note and set up an automatic payment that will pay this down in 20 years.

00;09;05;08 - 00;09;22;13

William Post

What I like about that is if life happens, you can always default back to the minimum payment. Let's say you're paying a few hundred dollars more on any given month in order to pay down the loan. But then life, something happens with life where you need the budget freedom.

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William Post

Maybe you're changing jobs and there's a lag in your paychecks. Maybe you've had some unexpected medical costs and you're having to pay co-pays more than you normally do. Maybe your auto insurance went through the roof because your child had an accident or you added a child to your policy.

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William Post

And now you know your budget, which was really friendly before, now just got rocked. Well, now you can go backwards. You have that kind of savings window there that you can utilize now, whether it's temporary or long term, you have the flexibility to make that choice.

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William Post

It's the same conversation, even with life insurance, you know, getting a larger policy and life insurance. And then and then over time, maybe shrinking that death benefit as needed versus having to increase the death benefit. You know, the only the only way you're going to change the policy or change the mortgage is to rewrite it.

00;10;13;22 - 00;10;24;05

William Post

And those are always at a future date where the numbers are unknown. They could be higher, they could be lower. And we have to make decisions based off what we have in hand today because the future is unknown.

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Andrew Baron

We've been discussing longer term loans, I wanted to get into some of the more obscure ones or I guess, uncommon ones such as, you know, maybe 5/1 ARMS, those adjustable rates. Could you talk about when those fit people better versus these 30 and 20 mortgages we've been talking about?

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William Post

Sure. So those types of loans tend to be a little scary for most people. Most people like a fixed interest rated note because there's no chance of it changing down the line. It's easy to budget for. It's easy for us to wrap our heads around.

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William Post

There's fewer moving parts. But a one or three or five year ARM, they're not bad options, particularly in a lower interest rate environment. For a one year ARM, your loan is fixed. Your interest rate is fixed for

one year and then the financial institution will put an index around it at after twelve months, where the rate may go up or down, potentially, based off of whatever, whatever that bank uses to set that index. And it can only go plus or minus by a fixed amount. You know, you're not going to go from paying 3% typically to 10% after that time horizon has expired of one year, three year, five year, whatever you have set up.

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William Post

Where are these a good fit? Well, the rates that we were just discussing are part of the conforming market. And with the conforming market, your house, your credit, your debt to income, all these things have to fit within a nice little box in order to qualify for those rates. Well, sometimes that's not the case. Perhaps you're buying a house that needs some fixing up. And it has some details to it right now that exclude it from being qualified from those markets.

00;12;19;02 - 00;12;32;11

William Post

Some examples could be maybe the type of siding, maybe the type of wiring that's in the house, maybe it's unfinished, maybe, as you know, the contractor started the house, but never finished the house. It has to be a finished property to conform.

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William Post

Maybe there's too much land associated with it. Not all conforming markets like houses that are on large pieces of land. You know, these are these are all things that kind of fall outside of the conforming rules. Well, that's when these other loans may be advantageous, they're typically an in-house product.

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William Post

So the underwriting process is typically less than a conforming product. They also give you a window to be able to maybe make the House conform. So if the House needs finished, you sign it up for a one or three year ARM, which gives you a time window to be able to fix the house and then before it adjusts, you refinance it to a conforming rate. That's one example that you can do. But let's say that it doesn't have to do anything with the house. Maybe it's more credit sensitive. Maybe your credit score isn't as high as it would need to be to be able to qualify for those conforming rates.

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William Post

So, for example, typically the cutoff is, if you're able to have a 680 or above score for credit, you're typically able to qualify for the better rates. But life happened and you have a lesser score. Maybe credit cards are bringing you down.

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William Post

Maybe there's some missed payments on a school loans that are accidental but had happened. They went 30 days past due. Maybe some unwanted medical bills showed up on your credit report. These are all things are very practical and they happen to good people.

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William Post

It's not always bankruptcies on your credit report, and that's why it's tanking down. Some of these are just real life situations. Maybe your credit score is at a 650 and you're not able to qualify for those great rates.

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William Post

But you can qualify for a one year ARM. And then during that period, we work together to increase your credit score to where it needs to be. And then we rewrite the loan and get you a fixed rate.

00;14;27;28 - 00;14;43;17

William Post

Sometimes these ARM rates are actually better than what's going on in the conforming market. You can get yourself a 15/30 year mortgage at three and a half, 4%. Well, maybe there's there's an offer right now, two and a half percent one year ARM.

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William Post

Well, if you're if you're buying a house, but you know, you're only going to be there short term and it's within that one year, three year window, well take advantage of the lower rate and the lower housing costs typically.

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William Post

That's assuming, you know that you're only going to be either temporarily or maybe you're buying a house and you have intention of transferring it to your children in the future. So you're buying it. You know you're going to be transferring it to them within that time window.

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William Post

Well, take advantage of some of these other programs that are out there. We don't have to be fixed loan or nothing in order for it to be a good fit and a valuable option for you.

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Andrew Baron

That was a good summary. I think especially with people, I think almost default to those earlier options. It's good to give some perspective. I think, especially the one about people that might be buying at a hot job markets where rentals are really high and they really don't anticipate staying for 10, 20 years, but long enough that maybe it makes sense that buy a home. Adjustable rate mortgages really might be much more preferable. So it's definitely something to consider.

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William Post

That's even an interesting topic, too, if you had to guess, Andrew, how long would you say the average person owns their home? In America.

00;15;57;08 - 00;15;59;00

Andrew Baron

I think it's eight years?

00;15;59;29 - 00;16;19;03

William Post

It’s 16.

Andrew Baron

OK.

William Post

And the average individual will go through three homes in a lifetime. Which to me, paints a whole different perspective picture as well talking about, and this is where the hard numbers and the life, the soft life parts really come together, right?

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William Post

You're signing up for a loan. What's the probability that you're actually going to be paying that thing off? No, it's really low, yeah, I mean, even if you're signing up for a 20 year loan, on average, we're selling our houses every 16 years, so you're not going to be able, you're not going to see the end pay off of that. So and while that's going on, mind you, your house has been appreciating, typically. I looked up recently where there was a chart that showed the inflation rate over the past 30 years. It also compared that to the housing price index.

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William Post

Well, the housing price index has outperformed inflation substantially over that whole time, even when we had that, what was it, the 2008-2010 mortgage crisis period where mortgages or housing prices tanked. It never fell below the inflation rate. Which means even when things, now this is just over the past 30 years, which means that during that time, like houses have appreciated and kept up with inflation. Right now, inflation is a really hot topic because right now inflation is at what, at six, 7% right now, which is admirable.

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Andrew Baron

Depending on how you measure it, yeah.

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William Post

Yeah, depending how you measure it. But over over the past 30 or so years, it has been between, what, one and 3% on the high side.

00;17;48;11 - 00;17;52;29

Andrew Baron

Well, let's say, especially since 2008, we've been at very low prices. So nearly 20 years.

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William Post

Yes. Yeah. And that's and that's important because particularly when you're talking about, what did you say, opportunity cost earlier?

Andrew Baron

Yes

William Post

Well, let's talk. Let's talk about how time value of money and how this plays into interest rates.

00;18;07;02 - 00;18;27;10

William Post

Right. So typically, inflation and the dollar value, they kind of work against each other. So when inflation is high, your dollar is worth less. When inflation is low, your dollar is worth more. What's that mean, practically? Well, the dollars you have today are worth more than dollars you have tomorrow when it comes to spending power.

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William Post

We're talking about budgeting and we all, you know, if we think about that, that makes sense. I look at how much I used to pay for my cell phone bill back when cell phones first came out. Compared to how much I'm paying now, I'm paying a lot more now than I did then, right?

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William Post

Well, how does this how does this relate to mortgages? When you sign that dotted line you're signing at today's dollar cost, it's locked in. Over time, things are becoming, things are going to be more expensive. If you're able to lock yourself in to a three and a half percent rate like that's on today's dollar.

00;19;04;27 - 00;19;23;18

William Post

So it's really important that we have that budgeting conversation, and we're just, we're intentional and we're smart with our with our dollars because we have to reallocate those dollars to make up for future expenses. And again, houses have traditionally appreciated faster than inflation.

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William Post

So know that while you're paying down your debt, every payment you pay, a portion of that goes to principle, which means your, your balance is less. All while your house is slowly appreciating. Assuming, assuming all things considered which puts you in a more equitable position. There's so many layers to the budgeting conversation when trying to figure out these long term debts and other areas to put monies. I'm sure you can give examples of working with clients, particularly in their in their later years, where maybe a mortgage made sense or keeping the mortgage made sense versus paying it down.

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Andrew Baron

It's actually funny you mentioned that. There was a couple I was working with where they had quite an expensive property that because of the value, was quite a big portion of their total assets and they probably could have stayed in the home.

00;20;18;08 - 00;20;41;08

Andrew Baron

And, you know, with Social Security cobbled together, you know, an OK retirement. However, especially because we locked in interest rates at a very low rate, taking equity and doing a cash out refinance made a ton of sense for them because we because we got a low rate we expect over the long term to easily outperform the interest rate and to be able to pay for those mortgage payments out of the cash flow. They were older. So as you were kind of talking about, we don't really plan on paying this mortgage off in 30 years since they probably won't live that long.

00;20;52;13 - 00;21;11;06

Andrew Baron

But for their lifestyle and for their lifetime, everything should work out very nicely for them. So that is something to think about. You can accumulate lots of wealth in your house, so sometimes people do reverse mortgages, but they can have some other risks associated with it.

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Andrew Baron

But doing a traditional mortgage or a cash out refinance might be a possible strategy as well.

00;21;17;03 - 00;21;39;05

William Post

Oh, absolutely, especially if you have a home and you're not really looking to sell the house or move out of the house, and you don't have family members that want your house. But maybe there is a way to tap into that value, liquidating that value because I'm sure your kids are more interested in the cash than the actual home, right? So how do we improve the cash?

00;21;43;03 - 00;21;52;06

Andrew Baron

There's also probate, you know, giving a house, it has much, there's a process involved versus just selling it, giving someone cash.

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William Post

Absolutely. Absolutely.

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Andrew Baron

We've been talking about low interest rates, and I think you even mentioned that the difference between a 20 and 30 year can be almost negligible. However, in the recent musings of the Fed last couple of weeks, we've talked about interest rate increases. Three, five, I've heard as high as seven rate increases over the course of the year. So besides the bond market, this is really going to see increases in mortgage rates. So the difference between a 30 and a 15 year might actually make, the calculus on that might seriously change twelve months, 18 months from now.

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Andrew Baron

So while we're talking about these differences now, we might listen to this podcast a year from now, the differences might actually make sense to go with the 15 year at that point, depending on the difference in interest rates. So it is always important to think about the, you know, the time period you're in and what makes the most sense for you. It kind of just goes back to how we started this, right?

00;23;01;08 - 00;23;20;16

William Post

Well, absolutely. I mean, most folks I've worked with, they're usually proud to share the stories of, you know, I'm amazed that I'm getting an interest rate now of three and a half percent because I remember when I bought my first home 20, 30 years ago and it was 14%. At the same time, my CDs and my bank were also earning 15%, right? And so that that shows to your comment about understanding the timing that we're in. You can't have the same “30 year debts are all bad, short term debts are all good”, without understanding the time window in which, which you're in.

00;23;39;23 - 00;23;54;22

William Post

Because if we go back to something that would resemble more of where we've been in the past, we're going. We're going back a long time, mind you, and we've been in a low interest rate market for a while now, and we've always talked about, well, the rates have to go up right, they have to go up. Well, they haven't.

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William Post

Now that we've just put all the stimulus money into the economy, the government and the Fed, they have to account for that. So now we're at the most realistic point that we've ever been, where it's very likely that interest rates will go back up.

00;24;09;01 - 00;24;25;03

William Post

Does change the, the dynamic of the conversation compared to what we said previously. But at the present, it makes for a very interesting conversation and there's a lot more opportunities in a low rate environment than there are with a higher rate environment.

00;24;26;07 - 00;24;28;13

Andrew Baron

Well, really appreciate you coming on the podcast.

00;24;30;02 - 00;24;34;03

William Post

Thank you for having me. It's a great topic, and I look forward to the next one.

00;24;35;08 - 00;24;55;07

Andrew Baron

In conclusion, questions you should be asking yourself are what are my money priorities? Do I want lower monthly payments or do I want a lower interest rate? And this question has to be balanced with what other opportunities am I giving up by putting a lot towards home costs?

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Andrew Baron

Then there are lifestyle priorities. Remember that a longer term mortgage has lower monthly premiums, but you can pay more. This gives you flexibility. So the question you should be asking yourself is, are you interested in this flexibility? Another question you should be asking is how long do you realistically think you're going to live in the current home? And then another question is, if you're considering thirty-year mortgages, would be, would you have trouble obtaining a 30 year mortgage? And would you possibly be better suited by a different loan? So to answer the question, should I have a 30 year mortgage?

00;25;37;15 - 00;25;38;25

Andrew Baron

Well… it depends.