

# The Great Debate:

## 30-Year Mortgage vs. 15-Year Mortgage

by DoughRoller <http://www.doughroller.net/mortgages/30-year-mortgage-versus-15-year-mortgage/>

Among the many personal finance debates, the 30-year versus 15-year mortgage is always high on the list. In one corner you have the interest savers who swear by the 15-year mortgage (think Dave Ramsey), and in the other corner you have the lower payment folks who swear by the flexibility of a 30-year mortgage.

We're in our second home, and in both we financed with a 30-year mortgage, so we've preferred the lower payments over the potential interest savings. But the truth is that there is no one "answer" to the 30-year versus 15-year mortgage debate. What works best for one homeowner may not work best for another.

Let's take a look at a mortgage example so we can see some real numbers, and then we'll look at the factors one should consider when choosing a home loan.

### 30-year versus 15-year mortgage

We'll use as an example a \$100,000 home loan. With a 30-year loan at an interest rate of 5.36%, the monthly principal and interest payment would be \$559. Over the course of 30 years, the buyer would end up paying a total of \$101,254 in interest. On the other hand, the same house mortgaged with a 15-year loan at an interest rate of 4.89% would feature a higher monthly payment of \$789. Over the course of 15 years, the buyer would pay interest totaling just 41.314.

The interest rates used were taken from Bankrate.com. Of course, interest rates change daily, but the same pattern holds. A 15-year mortgage results in substantially less total money paid because of the lower interest rate and shorter amortization. A 30-year mortgage results in significantly lower monthly payments, but high total interest paid. Note that you can check out current rates on Bankrate.com.

So which is best, a 15-year mortgage or a 30-year mortgage?

## How to Choose the Right Mortgage

Here are the critical factors to consider when choosing a mortgage to suit your income and lifestyle:

**Interest Rate Spread:** Generally, the interest on a 15-year mortgage will be less than the interest rate on a 30-year mortgage. The difference, referred to as an interest rate spread, varies. In fact, sometimes the difference in rates is minimal (say less than .1%) as was the case recently, and sometimes the spread can be 1% or more. The difference also fluctuates depending on the size of the loan (conforming versus jumbo).

The wider this spread, the more the interest rates favor a 15-year mortgage. When the interest rates are nearly identical, the numbers favor a 30-year mortgage.

**Monthly Income:** Every home buyer should carefully examine their monthly income and expenses to determine how much they can afford to reserve for a mortgage payment. Income should be calculated conservatively. For example, an individual who works in an occupation such as construction or oil drilling may enjoy a great deal of overtime pay, especially during the summer months. However, when it comes to making a commitment to a mortgage payment, overtime pay should not be factored into the budget. That extra income might not always be available.

Instead, the typical 40-hour work week should be used to determine how much one can afford to pay each month. Any additional overtime hours or extra bonuses should be set aside in savings to cover emergency situations or other financial responsibilities. This approach might mean that the monthly payment associated with a 30-year loan might be more practical in some cases.

As a general rule, it's ideal to keep your total mortgage payment under 30% of your income. Banks will approve loans at a higher percentage, but the payments get really uncomfortable, especially when they exceed about 35% of income. Over time as your income increases (hopefully!), the percentage will go down. We've found that once the payment gets below about 20% of income, you start to enjoy a certain level of financial flexibility in your monthly budget.

**Monthly Expenses:** The mortgage certainly isn't the only housing expense that a home buyer needs to cover. Other home related expenses may include homeowner's association fees, mortgage insurance, homeowners insurance and property taxes. All of these should be factored into your mortgage payment when assessing your ability to make the monthly payments.

In addition, most folks have other loan payments as well, such as car payments, credit card debt, and school loans. As a general rule, banks want to see total loan payments (mortgage plus all other loans) at 36% or less of monthly gross income. The 36% rule is a reasonable guide. Of course, the lower payments of a 30-year mortgage will make it easier to hit this mark for many.

**Spending Habits:** If you obtained a 30-year mortgage instead of a 15-year note, what would you do with the extra money you'd save each month from the lower mortgage payment? It may be easy to say you'd save it, and maybe you would, but this is an important question to answer honestly. For those that would save and invest this money, the relative difference between a 30-year mortgage and a 15-year mortgage fade away.

In some ways, you can think of a 15-year mortgage as a forced savings vehicle. By requiring the higher payment each month, a 15-year loan is in effect forcing the home owner to "save" the extra money by paying it against the loan. If you have the discipline to save and invest on your own, however, you may prefer to put that extra money in the stock market, other real estate investments, or even a [bank CD](#).

**Flexibility:** Because of its lower monthly payments, a 30-year loan gives a home owner the flexibility to make lower monthly payments or pay extra and retire the loan early. This is the primary reason we've always opted for a 30-year mortgage. But again, the above factors (interest rate spread, monthly income, and savings habits) to dictate one option over the other for you. But for us, the flexibility was just too great to pass up.

## **The Bottom Line**

The bottom line when it comes to home mortgages is that each situation is unique, and a number of factors can influence the decision between 30-year and 15-year mortgages. If you'd like to compare the different options, Bankrate.com offers a helpful 30-year versus 15-year mortgage calculator.

<http://www.bankrate.com/brm/dalsystem2/calculators/15V30/default.aspx>

So what's your take? Which is better, a 30-year or 15-year mortgage?