



# Homeownership Counseling Center (HCC)

## Addendum II – Interest-Only Loans

Interest-only loans are not a type of mortgage. Interest-only is a payment option that can be attached to any type of mortgage, dependent upon lender offerings. In contrast to traditional fully amortized mortgages, where you make payments of *principal and interest* during the entire term of the loan, mortgage loans with the interest-only option offer an initial period during which you only pay the interest portion of the traditional principal and interest payments. After the interest-only period, the loan converts to payments of both principal and interest. Loans with the interest-only option may have either a fixed or adjustable interest rate. In either case, payments of interest made during the interest-only period will not reduce the principal balance remaining on your loan. Therefore, payments due after the interest-only period will be higher for the remaining term of the loan than those made during the interest-only period. For most loans with the interest-only option, the principal and interest payments are calculated so that the loan is paid in full on the date of maturity.

**Example:** Traditional 30-year Fixed Rate, Fully Amortized Mortgage vs. 30-Year Fixed Rate Mortgage with an Interest-Only Option.

The examples below are based on a \$100,000, 30-year loan with a 5.5% interest rate.

	30-Year Fixed Rate Mortgage Fully Amortized	30-Year Fixed Rate Mortgage with 10-year Interest-Only period
Original Principal Balance	\$ 100,000.00	\$100,000.00
Monthly Payment Years 1–10	\$567.79 Based on current Amortization Schedules	\$458.30 (Interest-Only)
Interest Paid Years 1–10	\$50,675.67	\$54,996.00
Principle Paid Years 1–10	\$17,459.01	\$0.00
Principal Balance at the end of Year 10	\$82,541.00	\$100,000.00
Monthly Payment Years 11–30	\$567.79 (Principal and Interest)	\$687.89 (Principal and Interest)
Interest Paid Years 11–30	\$53,728.33	\$65,093.00
Principle Paid Years 11–30	\$82,540.99	\$100,000.00
Principal Balance at the end of Year 30	\$0.00	\$0.00
Principle Paid Life of Loan	\$100,000.00	\$100,000.00
Interest Paid Life of Loan	\$104,404.00	\$120,089.00

This example assumes that no payments of principal have been made during the interest-only period. With many interest-only loans, you have the right, but not the obligation, to make payments of principal during the interest-only period. A payment of principal during the interest-only period will reduce subsequent interest-only payments.