

## Rising Balloons Can Be Financially Deflating

by Broderick Perkins Reprinted from: [http://realitytimes.com/rtcpages/19990813\\_balloons.htm](http://realitytimes.com/rtcpages/19990813_balloons.htm)

*After 90 days of rapidly rising mortgage rates "balloon" mortgages are in vogue again.*

### *Beware of the hot air.*

Lenders and brokers hawk balloons because typically they are cheaper than 30-year fixed rates. Even though balloons aren't as cheap as one-year adjustable rate mortgage's (ARM) first year rate, they are often a better deal during the second year when the ARM jumps.

When rates rise quickly, as they have recently, a balloon mortgage's savings, well, balloons. Typically requiring 10 percent down, balloon mortgages are conforming mortgages (\$240,000 or less) that are often called "30-due-in-5" or "30-due-in-7" loans. They are amortized over a 30-year schedule, but after five or seven years of payments, the loan matures and a big fat balloon of a balance is due, hence the name "balloon" mortgage.

At maturity, you can pay off the mortgage, refinance, or in some cases, convert or reset the loan's interest rate for the balance of the 30-year fixed-rate loan.

Unlike ARMS which reset or adjust repeatedly over the life of the loan, resulting in multiple changes to the monthly payments, convertible or reset balloons come with only adjustment, Freddie Mac says.

Converting or resetting, however, is contingent upon your timely payments over the last twelve months of the loan, you can't have a second mortgage and other factors.

A Freddie Mac survey, released Aug. 12, extolls the virtues of balloon loan savings that range from \$278 to \$457 a year on a \$100,000 loan.

*"When rates go up rapidly, as they have recently, there's a huge rate difference between a five-year balloon and a 30-year mortgage," said Joel Spolin, president of Absolute Mortgage Banking in Palo Alto.*

"The relative difference between a 30-year fixed and a 5-year balloon is usually about 1/2 a point. In today's world, there's a full percentage point in the difference," he added.

In high-priced housing markets like California where larger mortgages are much more common, the savings easily eclipses the \$278 to \$457 a year reported by Freddie Mac.

Carolyn Bauer, for instance, a San Jose, CA homeowner saved \$1,200 a year for five years with a balloon mortgage she's since refinanced.

"We invested the savings in stock in Home Depot," she said joking about money spent on hardware for her home. Balloon savings is a given, largely for those who don't plan to be in the home beyond the balloon's maturity -- five or seven years, but studies show most homeowners hold mortgages fewer than five years.

Freddie Mac also concedes the obvious -- unforeseen events can quickly let the air out of your savings. If you can't refinance, pay off the balance or convert the loan at maturity the balloon bursts and so does your credit.

"A lay off, medical, inaccurate credit information, anything can prevent you from refinancing with the balloon comes due," said Richard Calhoun, broker owner of Creekside Realty in San Jose.

Also unforeseen is where rates will be in five or seven years. What if the balloon is converted right at a time when mortgage rates peak?

"The borrower is screwed," said Calhoun.

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