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Is a 15-Year Mortgage a Good Option for You?

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You are almost set to buy a home—you are pre-approved, the inspections are done, and you are looking for a good fixed-rate mortgage option. Will it be a 30-year mortgage or a 15-year mortgage? Each has its pros and cons.

Interest Rates

A 15-year fixed-rate mortgage will accrue less interest than a 30-year fixed-rate loan simply because it has less time to accumulate. For example, let's say you have a $350,000, 30-year fixed-rate mortgage at 4.5% interest. You will end up paying $1,773 a month for a total of $638,280 over the life of the loan (excluding taxes and fees)—meaning you will pay about $288,280 in interest. That could be enough for another house.

Keep in mind that mortgage interest is tax deductible up to $1 million of the principal balance, so even if the interest is high, you can grab some tax breaks out of it.

Now let's look at a $350,000 house with a 15-year fixed-rate mortgage at 3.5%. With the shorter mortgage, you'll pay $2,500 a month for a total of $450,000. That's only $100,000 in interest, significantly less than what you would pay on the 30-year loan. Also note that 15-year fixed-rate mortgages have a lower interest rate than 30-year fixed-rate mortgages.

If your plan is to absolutely spend the least amount of money overall, a 15-year fixed-rate mortgage is the way to go. But in order to do so, you will have to be willing to make some sacrifices.

Monthly Payments

Many people choose 30-year fixed-rate mortgages because of the smaller payments, which grant greater financial flexibility. While you will be paying more in the long run, you will have more money to work with in the present. A flexible budget will give you more room to invest in things like stocks, bonds and interest-bearing accounts, which can help counter-balance the high interest rates.

Also, you might have more money to invest in your home, which could increase its value later. Another good aspect of 30-year mortgages: you can pay over the monthly amount and not have a prepayment fee, so you can effectively pay off a 30-year mortgage in less than 30 years with the right amount of budgeting.

Since monthly payments on a 15-year mortgage will be higher, you won't have as much wiggle room and you might not be able to save as much. However, after 15 years you won't have any mortgage payments, freeing up capital to invest and spend freely.

Building Equity

The faster you pay off your mortgage, the quicker you build equity. A high equity will allow you to:

- Take out a home equity line of credit.
- Increase your chances of refinancing your home.
- Take out a home improvement loan.
- Take out a second mortgage.

The ability to leverage your equity for cash or credit can prove very useful. With a 15-year fixed-rate mortgage you will build equity in half the time it takes with a 30-year mortgage.

Planning for the Future

If you do choose a 15-year mortgage, you should be confident in your job's stability. Carefully consider your debt-to-income ratio. If you took a pay cut, could you still pay the bills and the mortgage? Do you have at least six months of emergency money saved up in case disaster strikes? You should also have enough money to contribute to your 401(k) and retirement IRAs. If saving is too difficult with a 15-year mortgage, consider taking a 30-year mortgage and paying more than the required monthly payment when you can.