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Are 30-year mortgages a bad deal?

One of the ideas behind getting a 30-year fixed-rate mortgage is it’s enough time for a borrower to get through their earning years and into retirement with a paid off mortgage.

Owning a home free and clear when you’re no longer earning an income sounds like a smart idea. But the idea is becoming a little outdated with most people moving, refinancing, or both before a mortgage is paid off.

Cutting that time in half can save a borrower a lot of money in interest paid, and get them out from under a mortgage sooner — if they can afford the higher monthly payment.

It’s a debate worth looking into for home buyers trying to decide between a 15- or a 30-year mortgage. Here are some circumstances to consider:

Lower payment, more interest on 30-year loan

One of the main advantages of a 30-year fixed rate loan is that the monthly payment is much lower — about $500 on a typical mortgage — making a home more affordable.

Daniel Joss, owner of Joss Financial Group in Wiliamsburg, VA., and a financial life manager, is a proponent of 15-year mortgages. With interest rates on both types of mortgages at about the same amount — 3.5 percent — a $250,000 mortgage for a 15-year loan will have a monthly payment of $1,787 and $71,000 in interest over the life of the loan, Joss says.

The same loan for 30 years drops $664 to $1,123 per month, but the lifetime interest more than doubles to $154,000.

Paying $83,000 less in interest with a 15-year loan is great when you reach that finish line sooner. If a 15-year loan was the hare, then a 30-year loan is the tortoise — as far as paying off the loan goes.

With a 30-year mortgage, how that $664 monthly savings is spent each month is up to the borrower, but most people won’t do what financial planners suggest — invest it. Instead, they make it part of their monthly living expenses, Joss says.

"In the long run you're paying the bank twice as much money so you can buy groceries in the short term," he says.

Buy more home with 30-year loan

This is one of the things that led to the housing crisis about eight years ago, Joss says, and still leads to bad decisions today.

Borrowers can afford a higher-priced home with the longer payments in a 30-year loan, allowing them to live beyond their means. Joss recommends getting a home with a 15-year loan that fits in your budget. Otherwise, it's a home you can't afford.

"If you can't make the payment on a 15-year mortgage with 25 to 30 percent of your income, that's too much," he says.

What will you do with the savings?

The safety and predictability of a 30-year fixed mortgage can give you peace of mind that your monthly payments will remain the same. It also gives you a lot of time to do something smart with the savings from a 15-year mortgage.

Again, if you go on the premise that you could afford your home with a 15-year mortgage and can save the $500 or so in monthly payments, then it's saved money that should be invested, Joss says. It shouldn't be spent on lifestyle changes such as paying cash for cars, he says.

"It's very difficult to make that steady, monthly payment to yourself," Joss says.

Convincing people to think 30 years ahead to retirement is difficult, he says.

"Long-term thinking doesn't sell," Joss says. "It doesn't go over particularly well."

More flexibility with 30-year loan

The lower payment of a 30-year loan can give families more wiggle room if they have financial difficulties such as a job loss or have some expenses come up, such as having a child. It also gives them more time for their incomes to hopefully rise, giving them extra money to pay off a 30-year mortgage early.

"When mortgage rates are this low, I would tell folks to get a 30-year mortgage," says A. W. Pickel III, president of the Midwest division of AmCap Mortgage in Overland Park, Kan.

Pickel’s advice to “lend long, pay off short” can turn a 30-year mortgage into 15 years with automatic payments, for example. Otherwise, invest the savings, which some financial planners say will earn them much more money than they’d save by paying off their mortgage early.

“If they can invest the money, they should invest the money,” Pickel says. “But they have to be disciplined to do it.”

The bottom line: Savings

The difference between a 15- and 30-year loan is how much money you can save. Would you rather have a 15-year loan with high payments now, no mortgage in half the time and less interest paid over the life of the loan?

Or does a 30-year loan with lower monthly payments, higher interest paid and the chance to save and invest the difference between the two payments sound like a better deal?

Joss, the financial planner who recommends 15-year mortgages, says focusing on the bottom line of how much more you’ll pay in interest with a 30-year loan and looking at the long-term picture can be difficult when much lower monthly mortgage payments are the other option.

“It takes a long time to get to the long term, so few people think about it,” he says.

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