5 Alternatives to the 30-Year Mortgage

If you're veering from the traditional home loan, here are some of your options.

By Geoff Williams, Contributor |April 9, 2014, at 2:45 p.m.

Homebuyers have several options outside of the standard 30-year mortgage, including paying in cash and taking out a 50-year fixed-rate mortgage. (iStockphoto)

If you're buying a house, chances are you'll take out a 30-year fixed-rate mortgage. It's the most popular home financing option, according to Freddie Mac, the government-sponsored entity that works to help homeowners get mortgages. In the last couple of years, those who took out home loans overwhelmingly chose the 30-year fixed-rate mortgage: It accounted for 85 percent of the home-purchase loan market in 2012, according to Freddie Mac, and 90 percent in the first half of 2013.

Even if you're planning to go this traditional route, it's nice to know what you could do instead. Here are some alternatives to the 30-year fixed-rate mortgage.

[Read: Before You Buy, Try That Mortgage on for Size.]

Paying in cash. Most homeowners can't afford to do this, so don't feel bad if the cash option isn't for you. But it seems remiss not to mention it. In Las Vegas, where there's been upheaval in the housing market with many foreclosed homes, cash buyers accounted for 43 percent of the home sales in March, according to the Greater Las Vegas Association of Realtors.

"In fact, over one-third of U.S. home sales in 2013 were all-cash deals," says Spencer Llewellyn, founder and executive director of Loans101 Interactive Media LLC. Its website, Loans101.com, offers educational mortgage information.

While you mull that statistic over and wonder where you went wrong since you aren't sitting on a few hundred thousand dollars, Llewellyn adds: "The lion's share of all-cash deals are completed by investors because of the view that home values have reached a bottom and have tremendous upside potential."

While paying for a house in cash is an alluring option, it's important to make sure you have plenty of excess money to draw upon if there's an emergency.

15-year fixed-rate mortgage. If you aren't going to get a 30-year fixed-rate mortgage, this is the next best alternative, according to many mortgage experts. The downside is that you'll have higher monthly payments than with a 30-year mortgage, but the upside is that you'll pay off the house faster.

That, and "you are building equity at a much faster rate, and if need be, you can take out another loan on the equity you have already invested in your property," says Pej Barlavi, CEO of Barlavi Realty LLC in New York City.

The best type of homeowner for this mortgage is a "borrower who plans on keeping their home for a long time and wants to save a large amount of interest they pay to their lender," Llewellyn says.

"Fifteen-year mortgages commonly come with an interest rate that's 1 to 1.5 percent lower than a comparable 30-year loan, saving [you] tens of thousands of dollars over the life of the loan," Llewellyn says.

20-year fixed-rate mortgage. If you worry that the monthly payments for a 15-year mortgage are a bit too high, but you could afford to pay considerably more than with 30-year mortgage, many lenders offer 20-year mortgages.

Some lenders will even go a more unconventional route and customize a mortgage for you, with terms of, say, 23 years – or perhaps 11.

[See: Debt-to-Income Ratio: Are You In Over Your Head?]

5/1 adjustable-rate mortgage. You'll save more money on your monthly payments with this option, Llewellyn says, but he only recommends it if you aren't planning to stay in your house for long.

That's a gamble, of course. As older homeowners know, life doesn't always work out as you plan, and that starter home could turn out to be the house you always live in.

With a 5/1 ARM, you'll have a low fixed interest rate for five years, and then for the next 25 years, the rate adjust every year according to the fully indexed interest rate. That would be an interest rate (often the prime rate, the interest rate banks charge their most creditworthy customers) plus a margin, which is a fixed percent rate. So you could have a prime rate of 4 percent with a margin of 5 percent, and suddenly the interest rate on your mortgage is 9 percent.

Bottom line: After those first five years are up, your monthly payment will change, and while it may not change all that much, it could be quite worse.

“I would not recommend the adjustable-rate mortgages, as I believe that the interest rates will rise in the next year or two," Barlavi says. "People that have this type of mortgage will see a big increase in their payments, which can put a stress on their household income. Many people before the 2006-2007 crisis had an ARM mortgage. Those are the people who took the biggest hits and lost their homes in foreclosure."

There are other ARMs. For instance, you could get a 10/1 adjustable-rate mortgage, where your interest rate is set for 10 years, then changes for 20. If you were positive you would move within 10 years, that might make financial sense – but again, there’s always the risk that you can't move and get locked into an unpleasantly high monthly mortgage payment.

50-year fixed-rate mortgage. Most experts advise steering clear of this option. You don't need a house that badly.

"New finance rules that were implemented in January left fewer alternatives available to 30-year mortgages," Llewellyn says, referring to restrictions put in place by the Consumer Financial Protection Bureau.

Llewellyn says lenders can offer loans with longer terms than 30 years, but many of the best banks avoid them because they aren't considered a good deal for the consumer – or the bank. "They're more risky to the lender if the borrower defaults," Llewellyn says.

[See: 10 Saving Strategies That Can Backfire.]

But don't worry about the lender. Worry about you. Having a 50-year mortgage is similar to paying rent, according to Dean Johnson, division president of Primary Residential Mortgage.

Sure, you'll have more affordable monthly payments than with a 30-year mortgage, and you'll live in a house. But when you sell it, unless you've been living there for decades, you aren't likely to have much equity or see much profit. That may not matter to you much now, but your future self might wish you had found a better deal.

Clarified on April 11, 2014: A previous version of this story didn't make clear that the 30-year fixed-rate mortgage accounted for 85 percent of the home-purchase loan market in 2012.

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