Fixed Rate Mortgage

By Kimberly Amadeo

Definition: The interest rate on a fixed rate mortgage stays the same throughout the life of the loan. The most common fixed rate mortgages are 15 and 30 years in duration. Since fixed rate loans have been around the longest, they are also known as conventional loans.

Each month's payment is equal to the the interest rate times the principal, plus a small percentage of the principal itself. Since a bit of the principal is paid off each month, that makes the interest payment on the remaining principal a little less too. As a result, more of your monthly payment goes toward the principal each month. Therefore, in the beginning of the loan, most of the payment goes towards interest, while most of it goes towards principal at the end of the loan.

Fixed Mortgage Rates

The interest rate is usually just a little higher than that of the 30-year Treasury Bond at the time the mortgage is issued.

Advantages

The advantage of the fixed rate mortgage over an adjustable rate loan is that the payment is the same each month. This predictability makes it easier to plan your budget. It's also a great loan if you think interest rates will be going up over the next several years.

Disadvantages

The disadvantage is that the interest is higher than an adjustable rate or interest only loan. That makes it more expensive IF interest rates remain the same, or drop. In addition, you gain equity slower than with an adjustable rate loan. That's because the payments over the first few years primarily go toward interest. Therefore, these are not good loans if you plan to sell your house within 5-10 years.

5-Year Mortgage

A 5-year fixed rate mortgage maintains the same interest rate for the first five years. It then turns into an adjustable rate mortgage. The advantage is that the initial interest rate is lower than on a 30-year mortgage. The disadvantage is what happens after 5 years. Your interest rate could start to increase very rapidly, depending on what current rates. Therefore, this is a good loan if you're sure you will sell within five years. (Source: SFGate, Pros and Cons of a 5-Year Mortgage)

15-Year Mortage

A 15-year fixed rate mortgage is very popular because it has lower interest rates. It also allows you to pay off the principal faster than with a conventional 30-year loan. This means you build up equity faster. On the other hand, 15-year mortgages have higher payments. For that reason, there's a slightly higher risk of default if your income drops.

30-Year Mortgage

A 30-year mortgage is the most affordable conventional loan. Even though it has higher interest rates, the monthly payment is lower because the loan repayment is spread out over 30 years. This is a good loan if you plan to stay in your home for a long time. It's also a good loan for lower-income families, because it allows you to buy more house with a lower monthly cost.

Interest Rate Trends

Interest rate trends have been declining since 1985. That's because inflation has been under control since then, thanks to successful Federal Reserve monetary policies. This has led to low rates on Treasury Bonds. As a result, the interest rates on 30-year fixed rate mortgages have been below 7% since March 2002. (Source: Freddie Mac Web Site.)*Article updated August 26, 20132*
Also Known As: fixed rate loan, conventional loan, conventional mortgage, 30-year fixed loan, 30-year fixed mortgage, 15-year fixed loan, 15-year fixed mortgage

Source: http://useconomy.about.com/od/glossary/g/fixed_rate.htm
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