Managing one's mortgage

» *By Judah Massias*

When buying a home, the majority of purchasers require a mortgage because they do not have the necessary financial resources to pay for a home outright. For many, getting an attractive mortgage is a very stressful procedure. But what is even more stressful is that one must make rather large monthly payments for up to 30 years.

The monthly payments of the borrower are primarily made up of interest payments. On a 30-year mortgage linked to the cost of living and bearing an annual interest rate of three percent, the borrower repays the bank more than three times the amount of the original mortgage. Consequently, since the interest payments make up such an important part of the overall monthly repayments, most people prefer to take out a mortgage bearing the lowest interest rate possible because they believe it will ensure the smallest monthly payments.

But as Omer Doron, managing director of Simple Mortgage, explains, "This is a very common mistake. Insufficient knowledge on the part of most borrowers means they will be making much higher monthly mortgage payments than could be. The smart way to take out a mortgage is by utilizing the different sources of funds and creating a mortgage mix that is the most advantageous. Our team at Simple Mortgage has perfected a system in which we are able to identify the mortgage mix that is most advantageous to the borrower."

The Simple Mortgage system is based on the fact that banks offer mortgages linked to the cost of living, bearing floating interest rates or fixed interest rates. They are shekel mortgages linked to some foreign currency or unlinked mortgages bearing floating rates (prime rate mortgages) or fixed interest rates.

At present, the interest rates in Israel are at a historic low; the prime rate stands at 2.25%. Consequently, interest rates on a prime rate mortgage are very low. Since the inflation rate is low and will probably remain so for the foreseeable future, it stands to reason that a prime mortgage is the least expensive and thus the most profitable.

It is the most profitable, but the Bank of Israel has limited the prime rate element in the overall mortgage to not more than one-third. The bank is being cautious. A rise in inflation rates will increase the prime rate, and this means that the monthly repayment payments may reach unsustainable levels.

Doron agrees that there is such a danger but says it can be managed. "Prime rate mortgage payments do not carry an early repayment fine clause; consequently, if inflation rates rise and the interest rate payments reach unsustainable levels, one can always repay the mortgage and get a linked fixed rate mortgage."

The figures for a wisely arranged mixed mortgage look attractive, even when the prime rate element is limited to one-third of the mortgage. Someone taking out a NIS 500,000 linked fixed interest mortgage bearing a 4% annual interest with an average monthly inflation rate of 0.30% repayable in 30 years will start paying the bank NIS 2,394.2. By the end of 30 years, he/she will be paying NIS 7,017.8, an aggregate amount of NIS 1,548,211.9, which is more than three times the original mortgage.

That same borrower taking out a NIS 500,000 mortgage of the right mix will start monthly payments of NIS 2,394.2, the loan will repaid in 21 years, the last monthly payment will amount to only NIS 3,826, and the total amount repaid will add up to NIS 835,002. The difference in the total payments is dramatic. It is too large to ignore.