Questions to Ask About Debt Consolidation

- Are your debts unsecured (such as medical bills and credit card bills) or secured only by an interest in personal property (such as a car or furniture payments)?
- Can you work out a payment schedule with your creditors to repay existing debts?
- How will you pay off a new home loan if you cannot pay your current bills?

There are many types of loans from which to choose: fixed rate, adjustable rate, balloon payment, and negative amortization. Loans may contain one or more of these features (e.g., an adjustable rate loan may or may not have potential negative amortization or a fixed rate loan may or may not contain a balloon payment provision). Discuss with your lender or broker which loan is right for you.

PAYING OFF A BALLOON PAYMENT LOAN

A balloon payment loan is not fully paid off through monthly payments. A loan without a balloon payment is repaid a little bit each month; each month's payment applies to both interest and principal. They are called fully amortized loans because you pay off (amortize) the loan with your monthly payments. By contrast, an interest-only loan or a partially amortizing loan will include one or more balloon payments; i.e., payments that are twice or more the size of the regular payment.

Partially amortizing and interest-only loans have lower monthly payments than fully amortizing loans for the same amount. In an interest-only loan, the monthly payments do not pay any of the loan principal. The payments cover only interest. The unpaid principal must be paid by one or more balloon payments.

For example, if you obtain a $15,000 interest-only loan at 10 percent interest for five years, you must make monthly interest payments of $125. At the end of the five-year term, however, you would still owe the entire $15,000 principal and it would be due in one balloon payment. (If you had made payments of $318.71 instead, the loan would have been amortized/paid off by the end of the five-year loan term. If your loan was for 10 years, monthly payments of $198.23 per month would fully amortize it.) A balloon payment results when your monthly payments pay only interest (a non-amortizing loan) or when they pay only part of your loan principal (a partially amortizing loan).

An example of each could look like this:

$15,000 Loan 10 % - 5 years	Monthly Payment	Balloon (Due after five years)
Fully Amortized	$318.71	—0—
Partially Amortized	$222.65	$7,500
Interest Only	$125	$15,000

With interest-only and partially amortizing loans, if you do not have the financial means to repay the balance of the loan principal as a balloon payment at the end of the loan term, your choices could include:

- Selling your home to completely or partially make the balloon payment;
- Taking out another loan—typically incurring more fees and costs—to pay off the balloon payment; or
- Losing your home to foreclosure if you fail to make the balloon payment.