Your Mortgage Manual

If your mortgage confuses the heck out of you, you're not alone: Thirty-four percent of homeowners don't even know what type of mortgage they have, according to Bankrate .com. Since your mortgage is likely the single biggest loan you'll ever take out, it's a good idea to understand at least the basics. Here's what you need to know:

Fixed-rate mortgage

This is the most popular mortgage, and for good reason: **The interest rate—and your payments—remain the same for the entire life of the loan (usually 15 or 30 years).** "Your payments might be higher than with other mortgages, but you'll always know exactly how much to pay each month," says Greg McBride, senior financial analyst at Bankrate.com.

Adjustable-rate mortgage (ARM)

Also known as a floating- or variable-rate mortgage, this loan offers the same interest rate for a limited time (anywhere from one month to 10 years). **After the initial period is up, your interest rate can then be adjusted depending on the fluctuations of certain market indexes that your loan is pegged to.** "Your later ARM payments will probably be higher than your initial ones," says McBride. Prepare yourself by knowing when your mortgage will adjust, which index and margin is used to price your rate, and what caps are in place to put a ceiling on increases.

Interest-only mortgage

With a traditional mortgage, part of each payment goes toward interest and part goes toward your principal. **With an interest-only mortgage, you pay only the interest for the first period of the loan** (usually five or 10 years). At the end of that time, you'll start paying the principal, too—and those payments *will* be higher. "These loans are attractive because the initial payments are so low," says McBride. But if you can't afford the later higher payments, you'll be unable to refinance or even sell your house if the market has weakened. Since you'll have paid only interest, you won't have actually built equity in your home. —*Lindsey Palmer*

Free $$$ Advice

Q&A WITH **DAVID BACH**

"I'm thinking about paying off my credit card debt with a home equity line of credit. Is this a smart move?"

REDBOOK Love Network expert David Bach is the author of seven best-selling books, including *Smart Women Finish Rich.* Visit his website at finishrich.com.

My simple answer is "no." Although it's reported that one in three people who have a home equity line of credit (HELOC) use it to pay off credit card debt, in my opinion tapping home equity to pay off your credit cards is a financial disaster waiting to happen. Why? Because too often those who use HELOCs to pay off consumer debt never learn from their spending mistakes. They wipe the slate clean only to max out their cards all over again, burying themselves even deeper in debt over the next two to three years.

Certainly, HELOCs offer some attractive benefits. They have low interest rates (the current average is around 7.5 percent), the interest is tax-deductible, and they're easy to get. In fact, many banks preapprove you for a HELOC right off the bat when you apply for your mortgage. However, most HELOCs come with an adjustable (not fixed) interest rate, which means your rate—and monthly payment—can go up at any time. Also, unlike credit card debt, a HELOC is a secured loan, which means that if you default on your payment, the bank could take your house as collateral. So ask yourself: **Do you really want to put your home—your greatest asset—at risk to pay off your credit cards?**

Bottom line, your home equity is your ultimate security. Use it wisely and it can help you become financially secure. But when it comes to credit card debt, pay it down the old-fashioned way: Renegotiate interest rates or consolidate your cards onto one low-interest card; pay more than the minimum each month; and simply stop using your cards and start using cash. In time, the balances go down—and you won't have jeopardized your home.

Have a money question for David? Email him at moneysmarts@redbookmag.com.

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