

Balloon Payments



A balloon payment is a lump-sum payment, over and above the regular, minimum monthly installments due on a loan. Often private mortgages (where the seller or a family member is the “bank”) will require periodic balloon payments. For example, a loan may allow interest-only monthly payments, but require a balloon payment of \$10k every January 1st. Private loans can be whacky like that.

Traditional mortgages from banks can require balloon payments, too. Most loans are what is called “fully amortizing”, which is to say, the minimum monthly payment matches the loan term loan. Pay the minimum payment every month and your loan will be paid down to zero over the specified time frame.

When a loan has a balloon payment, the monthly payment and loan term don’t match. A loan may have minimum monthly payment calculated as though the loan has a 30 year term, but at the end of 7 years, whatever balance remains comes due in a balloon payment. 5 and 7 years are common balloon due dates. If you haven’t already sold your home or paid off your mortgage by the time the balloon comes due, you’ll need to refinance to a new loan.

A variation on this theme is a “5/25” or a “7/23” loan. The minimum payment is based on a 30-year term but when the balloon comes due there is the potential for a built-in refinance. The

refinance will be at a market-based rate (figured using what are, in essence, a margin and an index, much the way an ARM works), but unlike an ARM, the rate only adjusts one time and then remains fixed for the rest of loan term. There are always conditions tied to this built-in refinance (good payment history, continued occupancy and a maximum rate increase are common), so it isn’t entirely automatic, but it can be a cheaper and/or easier alternative to a regular refinance.

Balloon loans are increasingly rare. Both consumers and the secondary mortgage market seem to have lost interest in these programs. Regulatory changes may well render them extinct. A balloon payment feature excludes a loan from being considered a Qualified Mortgage (QM) under the Truth in Lending Act.

