5.4.15

BALLOON LOAN AND BULLET REPAYMENT

BALLOON LOAN

Definition: *A type of loan which does not fully amortize over its term. Since it is not fully amortized, a balloon payment is required at the end of the term to repay the remaining principal balance of the loan.*

Balloon loans can be attractive to short-term borrowers because they typically carry a lower interest rate than a loan with a longer term. However, the borrower must be aware of refinancing risk and/or the risk that the loan will reset at a higher interest rate.

Some balloon loans, such as a five-year balloon mortgages, have a reset option at the end of the five-year term that allows for a resetting of the interest rate (based on current interest rates) and a recalculation of the amortization schedule based on a remaining term. If a balloon loan does not have a reset option, or frequently even when it does, it is expected that the borrower will sell the property or refinance the loan before the end of the original loan term.

BULLET REPAYMENT

Definition: *A lump sum payment for the entire loan amount paid at maturity. A bullet repayment is often linked to ballon loans or similar products. Bullet repayments are usually built in to the terms of the loans.*

For example, when a person has a five-year mortgage which is paid off in a lump sum at the end of the five-year term, this payment is considered a bullet repayment. Generally, the borrower only pays interest during this time, while the principal balance of the loan is due at the end of the term.

For large loan amounts, refinancing is usually required in order to pay the entire bullet repayment amount.

Sources: *http://www.investopedia.com/terms/b/balloonloan.asp*
http://www.investopedia.com/terms/b/bulletrepayment.asp