



PENNSYLVANIA ASSOCIATION OF COMMUNITY BANKERS

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Consumer Tips May 2008 - Are Extra Mortgage Payments An Option?



In the current economic downturn, many of us are looking for ways to rid ourselves of some of our debt. One way may be to pay off our mortgage sooner.

If you have a typical 15, 20 or 30-year mortgage, it may be advantageous for you to set up a bi-weekly payment plan or send in an extra monthly payment each year. Prepaying on your mortgage can take 5-7 years off of the life of your loan.

Paying extra toward your mortgage will help reduce the principal as well as reduce the interest you are paying in the long run. There are two ways you can make that extra payment.

If you are one of those people who need a more structured plan, there are several "mortgage savings plans" available. You divide your monthly mortgage in half and send in a payment every two weeks. By paying down your mortgage faster, you also have a better chance of getting a home equity loan or line of credit if you need it.

Let's say you have a \$150,000 home loan on a 30-year fixed interest rate at 6%. Not only will you pay the loan off 6 years faster, you'll also save about \$37,000 in interest.

Some lenders offer this service to their borrowers with a modest fee—others don't. While you should always check with your lender first, there are a number of third parties offering these services. You should work with a company known to be legitimate by your lender. You are sending money to a "conduit" and need to ensure they are a reputable company.

One thing to keep in mind is that these companies are in business to make money. They will generally charge you around \$500 to set up the payment plan and then a \$5 fee per month. They will make interest on your money while they are holding it.

The mortgage savings plan is not for everyone. If you are a young homeowner and plan to stay in your house for 10 years or less, the benefits of prepayment are inconsequential. You would probably be better off to put the equivalent of an extra mortgage payment per year in your 401K or stock options.

If you are a more disciplined consumer, you can take your monthly mortgage payment and divide it by 1/12 and send in that extra payment each month. Be sure you designate on your payment coupon that you want the extra payment to go toward your principal balance. You're still making the equivalent of an extra mortgage payment each year, but without paying any fees to a third party.

However, before you send in that extra payment, be sure your lender doesn't penalize you. Some lenders charge penalties for prepayments, especially to those borrowers with bad credit or subprime home loans. However, if you have a conventional or government-backed loan, prepayment penalties are extremely rare.

You might also consider using that extra payment to pay down high credit card debt. Since the interest rate on credit cards is much higher than on a home loan, it might be more fiscally advantageous for you to pay those balances down first.

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