Prepay Your Mortgage: Save Interest

Is reducing the length of your mortgage loan by accelerating your mortgage payments the right decision for you? Prepayment can save you money, particularly if you plan to reside in your home throughout the life of your loan.

Getting Down to Basics

Suppose you have a $200,000 mortgage at 7% for 30 years, your ordinary monthly payment (excluding real estate tax) is about $1,331, payable for a total of 360 months. The mortgage will ultimately cost you an estimated $479,022, which includes $279,022 in interest.

If you pay $50 extra per month (about $1.64 a day) toward that mortgage, you will cut your total interest payment to approximately $242,597, and you will own your home without a mortgage three years and three months sooner. In other words, the extra money you pay out at the rate of $50 a month will save you an estimated $36,430 in interest.

Clearly, the more money you prepay, the greater your savings. For homeowners who have **adjustable rate mortgages (ARMs)**, the practice of prepaying is especially wise when interest rates are low. Prepaying reduces your debt load if rates go up later, since interest payments are highest and principal payments are lowest at the loan's inception.

Things to Consider

Is there a downside to prepayment? It depends. Eventually, you will eliminate the income tax deduction you receive from deductible interest paid. Depending on your tax bracket, the amount of money saved should be reduced accordingly. In addition, if you know you will only be living in your current home temporarily, prepaying may not be as beneficial in the long run. It is important to thoroughly analyze your options before you proceed.

Another area of concern can be prepayment penalties. While once common, they may be limited or nonexistent on relatively new mortgages. Further, the competitive nature of lending has led banks, in some instances, to waive penalties and prepayment charges. In order to make prepayments, you can usually add the prepayment to your normal monthly mortgage check and mail one check to the bank.

Before proceeding with any type of plan, consult with your financial professional to ensure that your decisions are consistent with your overall financial goals and objectives.

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