

Prepaying your mortgage can save a bundle

Recently a senior officer of my mortgage company challenged me to substantiate my argument that prepayment of principal saves a homeowner thousands of dollars in mortgage interest.

Although I published a column on this topic several years ago, it is worth revisiting at this time.

The theory of mortgage interest payment

The theory of mortgage interest payment is straightforward. Since the monthly mortgage payments remain fixed throughout the life of the mortgage, initially most of the money goes toward interest payment. This is because the maximum amount of loan would be outstanding during the early years.

As time goes on, the outstanding mortgage balance continues to decline, and so does the interest portion of the monthly payment.

Obviously, during the last few years, most of the monthly payments are applied toward the principal, since the interest payments decline significantly during the final years of the loan.

This situation allows us to save significant amounts in interest payments. If during the second month of the mortgage, for instance, the homeowner pays an additional \$100 toward the principal, he will save on the interest on that principal for the rest of the time he owes this money.



finances and you

Sid Mittra

The same would be true for the payment toward the principal during subsequent months.

It makes a big difference

The accompanying table presents some startling results. For instance, if a homeowner with a 30-year, \$100,000 mortgage at 10 percent pays an additional \$100 per month toward principal, the following would be accomplished:

- The monthly payments would increase from \$877.58 to \$977.58.
- The loan would be paid off in 19½ years instead of in 30 years.
- The total interest payment over the life of the loan would decline from \$215,926 to \$125,417, a decline of 42 percent.

Another way of looking at it is to say that every dollar you prepay against a 10-percent mortgage means you save — and thus earn — 10 percent each year. This investment is safe, involves no sales charges and guarantees a 10-percent return on your money regardless of market fluctuations.

So the moral is this: By all

means prepay your mortgage if you can't find a more attractive alternative to investing your savings in your mortgage.

Sid Mittra is a professor of management at Oakland University and proprietor of Coordinated Financial Planning in Troy.

\$100,000 mortgage in 10-percent interest

type	mortgage will be paid off in	monthly payment	total annual payment	total interest over the life of loan	saving on interest payment	percent saving
30-year mortgage	30 years	\$877.58	\$10,531	\$215,926		
30-year mortgage	19½ years	\$977.58	\$11,408	\$125,417	\$90,499	41.9%

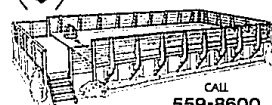
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