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## Cover story: How to save money, build equity faster

By Michele Lerner

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In the rush to refinance in 2010, some homeowners were left behind, unable to arrange for a new home loan because of a lack of equity or a too-low credit score or some other glitch in the world of tightened credit standards.

While many homeowners refinance to reduce the size of their monthly mortgage payments, others have the goal of paying off their mortgage earlier to become debt-free before retirement and to save money on interest. Homeowners who want to hasten their mortgage-burning celebration may want to consider other options besides refinancing.

There are several methods for shortening the term of a mortgage, including making biweekly mortgage payments, making an additional mortgage payment each year or paying extra principal each month.

[Sandy Johnson\(/topics/sandy-johnson/\)](#), a financial specialist with [Clear Point Credit Counseling Solutions\(/topics/clear-point-credit-counseling-solutions/\)](#) in Fredericksburg, Va., says homeowners interested in paying down their mortgage faster should start by checking to make sure their loan does not have a prepayment penalty.

"Homeowners should check with their lender and go back to their settlement papers and original note to be sure they can repay their mortgage earlier without paying any fees," [Ms. Johnson\(/topics/sandy-johnson/\)](#) says. "If there are no fees, then paying down your mortgage can have a big benefit since you not only reduce the principal more quickly, but you also save thousands of dollars in interest charges."

Homeowners who are paid every two weeks are most likely to find a biweekly mortgage plan appealing because they can pay half of their monthly mortgage payment with each paycheck. Because there are 52 weeks in the year, resulting in 26 paychecks, they will end up making 13 mortgage payments each year rather than 12.

Some lenders offer a biweekly mortgage option for borrowers, but most charge an upfront fee to set

up the account plus a fee of a few dollars for each payment for the extra administrative work associated with additional payments. These charges can add up over the course of the mortgage and reduce the impact of the additional payments.

"Lenders usually charge \$400 to \$600 to start the borrowers on a biweekly mortgage program and then charge \$3 or \$4 for each transaction," says [Bill Burnett\(/topics/bill-burnett/\)](#), president of [Homestead Mortgage\(/topics/homestead-mortgage/\)](#) in Lorton, Va., and president of the [Virginia Association of Mortgage Brokers\(/topics/virginia-association-of-mortgage-brokers/\)](#). "There are definite advantages to making biweekly [mortgage payments] because you can reduce your loan term from 30 years to about 21 years, but this same advantage can be gained at no cost if borrowers arrange to make extra payments themselves."

[Mr. Burnett\(/topics/bill-burnett/\)](#) points out that homeowners who are underwater on their home loan, owing more on the mortgage than their property is worth, usually are unable to refinance. Making additional mortgage payments can be one way for them to regain lost equity in their property more quickly than simply making standard payments and waiting for the market to improve.

Lenders often will arrange for biweekly payments to be paid into a separate account and then withdrawn once per month, with the leftover funds applied at the end of the year for an additional mortgage payment.

A standard mortgage payment plan for a \$400,000 30-year, fixed-rate mortgage at 5 percent interest would cost \$2,147 in monthly principal-and-interest payments with a total interest payment for the life of the loan of \$373,023. Switching to biweekly payments on that same loan would result in payments of principal and interest of \$1,074 every two weeks. The loan would be paid within 25 years, and the total interest paid would be \$307,626, for a savings of \$65,397.

[Brian Martucci\(/topics/brian-martucci/\)](#), owner of [GetLoans.com\(/topics/getloanscom/\)](#) in the District recommends that homeowners opt for a do-it-yourself version of biweekly mortgage payments to save on bank fees and to allow for financial flexibility.

"Why pay for something you can do yourself?" [Mr. Martucci\(/topics/brian-martucci/\)](#) says. "But, human nature being what it is, some people don't have the discipline to make extra mortgage payments. If you don't trust yourself to do that, it may be worthwhile to pay for the lender to set up a biweekly program."

[Ms. Johnson\(/topics/sandy-johnson/\)](#) warns, however, that homeowners arranging a biweekly payment plan with their lender should ask if they will be able to revert to a standard payment plan if their financial circumstances change. In addition, homeowners need to understand that they cannot simply split their mortgage payment into two without discussing this with their lender. Sending one-half of the payment before the due date and one-half after the due date could result in late fees, eliminating the advantage of making extra payments.

As an alternative to biweekly payments, [Mr. Burnett\(/topics/bill-burnett/\)](#) recommends that borrowers make one extra mortgage payment each year to achieve the same goal of principal reduction and a faster loan payoff without paying lender fees.

"Make sure to write a separate check with a separate date from your usual mortgage payment and note that this payment should be applied to the principal only so that the lender does not simply apply this payment to your next due date," [Mr. Burnett\(/topics/bill-burnett/\)](#) says. "Check your balance on your next mortgage statement to be certain that the payment has been applied correctly."

Homeowners who make their mortgage payments online can make a separate payment designated as an additional principal-only sum.

While the idea of making an extra payment each year sounds good in theory, it can be difficult for many homeowners to come up with the cash without some planning.

[Mr. Burnett\(/topics/bill-burnett/\)](#) recommends setting up a separate bank account for mortgage payments and adding one-half of the mortgage principal and interest every two weeks. If the monthly mortgage payments are made from this account, there should be an additional full payment remaining in the account after the Dec. 1 mortgage payment has been made. Writing a check or arranging an online payment from that account should be done before the end of the year.

[Ms. Johnson\(/topics/sandy-johnson/\)](#) suggests that homeowners can benefit in a similar way by adding money to every payment. For example, if the borrowers normally pay \$1,500 every month for their mortgage payment, they can pay an extra \$125 with each payment (one-twelfth of a mortgage payment) to gain the equivalent savings of an extra payment each year.

Borrowers can go beyond reducing their mortgage principal by one extra payment and can calculate how much to pay to reach a particular payoff date. [Mr. Martucci\(/topics/brian-martucci/\)](#) says he used the mortgage calculator on his website to create a 20-year fixed-rate mortgage for himself without paying to refinance his 30-year loan.

"You can quickly set up a loan payment plan for yourself and then automatically arrange to have the new payment amount deducted from your paycheck and transferred for your mortgage payment," [Mr. Martucci\(/topics/brian-martucci/\)](#) says. "I have a 30-year mortgage and have been making payments as if it was a 20-year loan for the past five years. Now I have only 15 years left on the mortgage."

Homeowners who are planning on moving in a few years may be less interested in paying down their loan, but for those staying in the property for the long term, the savings can be substantial.

"Homeowners should focus less on their monthly payment and more on the total payment for their home," [Mr. Martucci\(/topics/brian-martucci/\)](#) says. "Paying off the mortgage more quickly can result in thousands, even hundreds of thousands of savings in interest, depending on the size of the loan."

Whether the homeowners opt for a lender-approved accelerated mortgage plan or choose to make extra payments on their own, they should be sure to document their payments and designate them toward the principal.

While there seem to be few disadvantages to reducing a mortgage balance, borrowers need to be particularly careful to avoid any prepayment penalty from the lender. In addition, homeowners should be sure the additional mortgage payments are part of an overall financial plan.

"Homeowners should be sure they have enough money set aside for emergencies before they consider making extra payments to anything other than a savings fund," [Ms. Johnson\(/topics/sandy-johnson/\)](#) says. "After they have an adequate emergency fund of at least three months of living expenses, the homeowners should look carefully at their budget to see if they should be paying off other high-interest debt instead of reducing their mortgage faster. For many families, the mortgage is the biggest part of the budget, but it often has a lower interest rate than credit-card debt."

[Ms. Johnson\(/topics/sandy-johnson/\)](#) says each household should look at the whole picture before deciding on a biweekly mortgage plan or on making an extra mortgage payment each year because there may be a better way to use any additional income.

[Mr. Burnett\(/topics/bill-burnett/\)](#) agrees, saying, "Everyone should look at their mortgage as part of an overall strategy to accomplish their financial goals. In some financial markets, you could be earning interest by investing the extra cash each year that would outweigh the benefits of paying down your mortgage. Right now, certificates of deposit and other savings vehicles are paying such low interest that paying extra on your mortgage is probably a better choice."