

## Pre-Paying Principal On A Waterfront Home

by Joe Catalano

Chances are you don't own the waterfront home you are living in. While owning a home is the American dream, most people really never do. When they move or die, it's the bank that usually owns most or at least part of the property because of the outstanding mortgage that still remains.

However, you **can** own the entire house free and clear - and sooner than you think - if you make it a habit to prepay principal. Prepayment is nothing more than mailing in extra principal along with one or more of your mortgage payments each year. You not only pay off your loan sooner, but you also save a fortune in interest.

For example, on a 30-year loan of \$200,000 written at 6.5 percent, the monthly principal and interest payment is \$1,264.14. The total amount of interest paid on that loan if held full term is an astounding \$255,086.02. This means that the \$200,000 loan is actually costing \$455,086.03, but send in just an extra \$15 each month with your regular payment and you'll save \$10,679 in interest and end the loan a year sooner. Send in an extra \$100 per month - probably what you spend on Starbucks coffee each morning during that period - and you save \$55,945 in interest and end the loan 5 years and 7 months early.

Most people know that each monthly payment is composed of interest and principal. In the loan's early years, the payment is comprised mostly of interest. Halfway through the loan's term, it's about 50 percent interest and 50 percent principal. The last payment is 99 percent principal.

Loan payments are set up this way so that the lender can make as much interest, also known as profit, as quickly as possible. Even if you refinance or sell your

home a few years after purchasing, the lender still has collected a lot of interest. As a loan nears the end of its term, lenders often mail out a letter saying that the homeowner can end his mortgage by sending in the remaining principal. You end up owning the home free and clear a few months sooner, but at this point you've paid most of the interest on the loan. There's really no benefit to you. In fact, it's better to keep the loan going and have someone pay your taxes and insurance via the escrow account.

When you send in extra principal in the early years of the loan, it is applied to the back end or final payment. As the lender receives the extra money, the final loan payment advances forward, which is how the loan ends sooner. The more extra principal you send, the more quickly the loan ends and the more interest you save. You can prepay by sending extra principal monthly or in one lump sum annually. However, the earlier in the year that you prepay, the faster the loan's term is reduced. Many use their tax refunds to prepay principal. Even sending in as little as \$1 a day can save about \$20,000 in interest on a \$100,000 30-year loan. (It should be noted that you can't really send in \$1 a day. Lenders want the extra funds included with each mortgage payment.)

Think of prepayment as a forced savings plan where the return is your mortgage interest rate. In addition, you are building equity in your home faster. Mortgage coupons usually have a place for designating how much extra principal is being sent. If the coupon doesn't have a space, then include a note stating that this is what the extra money is for. This is so that the lender doesn't think you are just sending money

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