Charlotte.com

Tuesday, Jan 22, 2008

Posted on Mon, Jan. 21, 2008

Pay mortgage early?

AMY BALDWIN

Mary and Jim Vaca aren't like most Americans: They hate debt.

They're working toward paying off the 30-year mortgage on their Ballantyne home -- their only debt -- early. The Vacas, who borrowed $250,000 two years ago, base their monthly payments on a 15-year schedule.

A nationwide housing slump and uptick in foreclosures no doubt make the idea of paying off the family home early more appealing. Before you start making heftier mortgage payments, there are a few things you should know, including why experts say you should or shouldn't do it and how to make sure your cash really brings down your loan.

Those in favor of getting rid of the mortgage ASAP say it gives people priceless peace of mind and frees them to save more aggressively for retirement or even retire early.

Those opposed say it doesn't make financial sense to pay off debt that has relatively low interest and tax-deductible interest, especially when many Americans are not saving enough for retirement. They say that any extra money people have to pay more on their home loan would be better off invested where it could earn more money -- i.e. in the stock market. (See sidebar.)

But Mary Vaca, 30, doesn't believe people are sufficiently disciplined to find extra cash in their budget and invest it. And she questions whether it's even worth it.

"You are playing the numbers," said Vaca, a consultant for Accenture, a management, technology and outsourcing services firm. "I would rather be 45 and have my entire paycheck coming home with me than be 45 and saying (that) I made an extra $20,000 playing the numbers game."

What financial experts generally agree on is that before you throw more money at your mortgage, you should pay off higher-rate debts, such as credit cards, car loans and student loans. Justin and Sarah Serpico of Weddington, for example, should be tackling their two car loans with a combined balance of $20,000 before paying more on their house. The couple is enrolled in a payment program that enables them to make what amounts to one extra payment a year.

And experts generally agree that you should be funding your retirement accounts -- 401(k) and IRAs -- to the max before making extra mortgage payments. Mary Vaca saves 12 percent of her pretax income in her 401(k), while husband Jim, 29, saves 15 percent in his with Bank of America. They also are putting $200 a month into their 19-month-old daughter Ava's college fund.

"If they have extra cash and they are not contributing to their 401(k)s, they are missing out on great tax benefits and bigger returns," said Eric Tyson, author of "Mortgages for Dummies" and "Personal Finance for Dummies."

So long as retirement accounts and debts are taken care, it's whatever makes homeowners comfortable, said Tom Nichols, a certified financial planner at Rinehart & Associates in Charlotte.

"Some people just don't like to have that debt over their head," he said.

Thinking of paying off your mortgage sooner than later? Here's what you need to know.

Your lender can probably set you up

Many lenders have mortgage acceleration programs that allow customers to pay on a 15-year schedule or make biweekly payments. Paying every other week equals an extra payment every year.The Serpicos enrolled in a biweekly payment program with their lender, the mortgage unit of JPMorgan Chase & Co. They will pay their loan six years earlier and save $90,000 in interest, said Justin, 33, an information technology analyst at Bank of America.

"That gives me a lot more options in terms of if one of us wants to retire sooner," he said.

But these programs aren't always free.

For example, depending on the type of loan, Wachovia Corp. charges a one-time fee of $150 to $250 for customers who want help paying it off quicker. Bank of America Corp. charges a one-time fee of $379 to convert a loan to biweekly payments.

You can do it yourself

Not sure how much you need to increase your payments by to pay off your mortgage quicker? You don't have to be a loan officer to do the math. There are lots of online calculators to help. That's how the Vacas came up with their payment plan.

Sites with mortgage calculators include www.fool.com, www.vertex42.com (this one creates cool Excel spreadsheets) and www.bankrate.com.

I used www.interest.com to figure out what it would take to pay off a $200,000 30-year fixed rate home loan -- at 5.4 percent -- in 15 years instead.

The monthly payment on a 30-year schedule: $1,123. The monthly payment for 15 years: $1,623.

Don't want or can't afford to be that aggressive? Here's an easy-to-remember strategy: Adding 10 percent to your monthly payment or making one extra payment a year will shave six to seven years and thousands in interest payments off your mortgage. Cutting your monthly mortgage in half and paying that amount every two weeks will accomplish the same.

At Bank of America, 1.2 percent of its 2.5 million mortgage holders are enrolled in an automated early payment program, said spokesman Terry Francisco. But a third make an extra principal payment every year.

You should pay to enroll in an early payment program only if won't make the extra payments on your own, said Todd Calamita, certified financial planner at RBC Dain Rauscher in Charlotte. "The only advantage I can see is if it is a discipline thing. They are doing it for you. You are paying a fee," he said.

Direct your extra cash to the loan principal

Make sure your lender knows that the extra cash you send in or have drafted from your online bank account should be applied to the loan principal. That's how to cut down how long and how much interest you'll pay. If you mail your payment, the loan coupon probably has a box to check indicating that the extra money goes to principal. If you are paying online it could be trickier. Wachovia, for example, said customers should call customer service or send an e-mail to make sure payment is applied correctly.If you pay extra and don't follow up, your lender could apply that money to interest -- ouch! -- or credit a future month's payment so that you end up ahead on some payments, which is not as financially advantageous.

And, of course, check your mortgage account balance regularly. Banks make mistakes, too.

Remember, you're not locked in

Why not just get a shorter-term mortgage to start? Mary Vaca said she and her husband "didn't have the guts" to get a 15-year loan. That's the thing. Get a shorter loan and you are committing to bigger payments even if your cash flow tightens because of job loss, illness or unexpected expenses. Whether you get a 30- or 15-year mortgage, interest rates still are at historic lows. Last week, the average national interest rate for a 15-year mortgage was 4.93 percent, compared with 5.42 percent for a 30-year loan, according to Bankrate.com.

Out of the Red Amy

Baldwin **Paying off your 30-year home loan in 15 years: How much will you save?**

On a $200,000 loan with a fixed interest rate of 5.4 percent -- the current average rate, according to Bankrate.com -- you'd cut your interest payments by more than half. Take 30 years and you'd pay

$204,302 in interest, compared with $92,243 if you paid up in 15 years, according to calculations done on the online calculator at www.move.com.

Pay your mortgage off early?

AGAINST Pay off early and you aren't taking advantage of super-low borrowing costs, easily beatable by other investments, said Jim McGehee, certified financial planner and partner at Alpha Financial Advisors in Ballantyne.

People who have long-term fixed mortgages with rates between 5.6 percent and 6.5 percent end up having a net borrowing cost of about 4 percent after the mortgage interest tax deduction, he said.

"If they can earn a rate of return of say 8 percent per year on their investments, and let's assume worst case that they have to pay taxes on that return -- they don't put it in a tax deferred account -- that probably costs them about 1.8 percent. They still net 6.2 percent versus the 4 percent cost of the mortgage," he said in an e-mail.

But McGehee admitted, "There is also the non-financial aspect of the decision. Some people just want the `safety' of not having a mortgage, whether it makes the most financial sense or not."

What will he do?

"I plan on sending my last payment to Countrywide in October of 2032, and not a day sooner." David Bach, author of "The Automatic Millionaire Homeowner," understands that homeowners could make more money by investing extra cash in a mutual fund than paying off their mortgage early. But in his experience (he became a financial adviser in 1993, working for Morgan Stanley), he's found "people who pay off their mortgages early retire early."

"It's not the asinine hypothetical illustration that ...if you took this money and put it in a mutual fund and earned 9 or 10 percent. In the real word, people are not disciplined to do that," Bach said.

Besides, the returns on other investments are not guaranteed, but the money you save in interest is, said Dave Ramsey, author of "The Total Money Makeover."

"One hundred percent of the time you pay off your mortgage they no longer charge you interest," Ramsey said.

What about losing the tax deduction?

In the 25 percent tax bracket, he said, "you are spending $10,000 to save $2,500, which is ludicrous." Out of the Red Amy

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