ALASKA HIGHWAY NEWS

Smart Money: Extinguishing your largest liability

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Brad Brain: "Your mortgage just sits in the background, quietly siphoning off tens of thousands of dollars in interest expense. Fortunately, there are some simple, painless tactics that have the potential to shave years off your mortgage and save tens of thousands of dollars in interest." | Getty Images

For most people the biggest thing they will ever buy is their home, and the biggest liability they will ever have is their mortgage. But, unless your mortgage is coming up for renewal, the odds are good that you are just going with the flow, and not giving a lot of thought to how you can get rid of your mortgage quicker.

Meanwhile, your mortgage just sits in the background, quietly siphoning off tens of thousands of dollars in interest expense. Fortunately, there are some simple, painless tactics that have the potential to shave years off your mortgage and save tens of thousands of dollars in interest.

To illustrate, lets look at a $400,000 mortgage with monthly payments of principal plus interest over a five-year term and a 25-year amortization. If you are unfamiliar with the lingo, this mean you are borrowing $400,000, locking in your interest rate for the next five years, and you are looking at 25 years to have the entire $400,000 plus interest repaid.

I jumped on the website of a financial institution and see that they are currently offering a 5-year closed mortgage at 2.44%. Under this scenario, your monthly payment is $1779, it is going to take you 25 years to pay it off, and you can expect to pay about $133,979 in interest expense.

Let's see what we can do to save some money and reduce the amount of time to become debt free.

Often the first thing that people will do is to try to reduce the interest rate. There is no question that a low interest rate is preferable, but is this the most impactful thing? This may come as a surprise, but just reducing your interest rate may not make as much of a difference as you might expect.

Here is an example. The same financial institution offers a 2-year term at 2.09%. That is 14% less that the five-year rate, but this option means that it will still take 25 years to pay off your house, and it will still cost $113,367 in interest.

Reducing your interest rate is fine, but what else can we do? For starters, be sure to check out the prepayment options.

Let's say that you simply bump up your mortgage payment by a hundred bucks. In other words, the required payment is $1779, but you set your payment at $1879 per month. This simple thing, paying an extra hundred bucks a month on your mortgage, will shorten your amortization by almost 10 years, and save you about $43,260 in interest expense!

Another powerful option is to pay biweekly rather than monthly. Typically, every two weeks you pay half as much as a monthly payment. The savings happen because twice a year you make three payments in a month instead of two. Switching to biweekly payments would save about $52,470 and knock off about 11 years 10 months off your amortization.

You don't have to go with a 25-year amortization. If you set your amortization to 15 years right off the bat, then your mortgage is also paid off in 15 years. But this would require a minimum payment of $2653 per month. You can accomplish the same result just by paying extra on a 25-year amortization, and you have the flexibility of reducing your extra payments if necessary.

In the current interest rate environment, there can be a temptation to lock in at a low interest. But beware of potentially punitive costs to break a mortgage. Locking in for five years may seem appealing, but if you are not planning on being in the house for at least five years it might not make sense.

Don't forget that you can combine these strategies for even more savings. Make sure you discuss your options with your mortgage professional and do all you can to take advantage of them.

Getting a mortgage is exciting. Getting rid of a mortgage is even more exciting.

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