Should you make extra mortgage payments?

Find out if prepaying your mortgage makes financial sense for you

Many mortgages let you pay off the loan early to save money on interest. You can do this by paying extra each month, making an extra payment every year, or just paying extra when you can. Refinancing is a form of prepayment since you pay off your current mortgage and replace it with a new mortgage that has a lower interest rate or better terms. You will need to complete a new application and pay a new set of closing costs when you refinance, however. Think about these questions before you decide to prepay your mortgage or refinance!

Does your mortgage have a prepayment penalty?

Check if there is a prepayment penalty, which might reduce the amount of money you save. Some prepayment penalties only apply during the first years of the mortgage. If you're close to reaching the end of the prepayment penalty period, it may be better to wait.

How much money will you save by making extra payments?

How much you might save on interest by prepaying depends on many things. Your interest rate, the amount of principal you owe, your mortgage term, whether you have a fixed or adjustable rate, how long you plan to live in your home, and the amount you can pay extra all affect your potential savings. Consider this example for a 30-year fixed rate mortgage with an interest rate of 4%.

Without making extra payments toward the principal balance of the mortgage

Loan amount: $225,000.00
Interest rate*: 4%
Monthly principal and interest payment:** $1,074.18
Extra monthly payment made toward the principal balance of the mortgage: $0.00
Total monthly payment (including additional payments made toward the principal balance of the mortgage): $1,074.18
Total potential savings on interest by making extra payments*:** $0.00
Time to pay off loan: 30 years

With extra payments made toward the principal balance of the mortgage
Loan amount: $225,000.00
Interest rate*: 4%
Monthly principal and interest payment:** $1,074.18

Extra monthly payment made toward the principal balance of the mortgage: $125.82
Total monthly payment (including additional payments made toward the principal balance of the mortgage): $1,200.00
Total potential savings on interest by making extra payments*:** $33,020.21
Time to pay off loan: 24 years, 7 months

*Rate is an example only and may not reflect either your current interest rate, or the rate that is currently available.
**You may also be required to make monthly escrow payments for taxes and insurance as part of the mortgage obligation. Actual payment obligation may be greater.
***The amount of savings will vary over time depending on individual circumstances. The longer a consumer retains the property and loan at the stated rate, the more interest savings will be realized.

Keep in mind the sample savings above come from making extra payments over on a 30-year mortgage. Your savings will be much less if you make extra payments of principal for only a few years.

What are the advantages of making extra payments versus refinancing?

One advantage of prepaying your mortgage instead of refinancing is you don't have to pay closing costs. The money you might spend on these costs goes to paying down your mortgage principal instead.

Another advantage is you aren't committed to paying more each month. Sometimes when homeowners refinance, they shorten the loan term. This can save money, but it can also increase your minimum monthly payment. When you decide to make extra payments on your current mortgage, you can pay as much or as little extra as you want each month – including nothing extra at all.

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What are the advantages of refinancing versus extra payments?

One advantage of a refinance is you can get a new interest rate. When rates are significantly lower than the rate on your current mortgage, refinancing lets you reduce the amount of your monthly payment that goes toward interest and apply it to your principal payment instead.

By refinancing, the total finance charges may be higher over the life of the loan. It is important to keep your monthly payment and loan term the same to save money on interest when you refinance. If you reduce your monthly payment or extend the term of your mortgage, you may pay more for interest over the life of the loan. Use our mortgage refinance calculator to estimate your potential savings in different scenarios.

Refinancing also lets you change the other terms of your mortgage. You could get more predictable interest payments by going from an adjustable rate to a fixed rate mortgage. You might be able to stop paying the mortgage insurance premiums of FHA loans by refinancing to a conventional loan too.

Is making extra mortgage payments the best use of your money?

Before you make extra payments, decide if this is best use of your money. For example, if you have credit card debt with an interest rate of 17%, you may want to pay off this debt before you make extra payments on a mortgage with an interest rate of 4%. If you are saving for college or retirement, you might decide it is better to put the money in these investments. And if you don't have an emergency fund, you might want to build up your rainy-day reserve first.

Refinance versus making extra mortgage payments

Would you like to talk to a Freedom Mortgage Loan Advisor about whether refinancing your mortgage might make sense for you? Get Started today or call us at 877-220-5533.

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