# **7. Mortgage and Auto Loan Management**

Mortgages and auto loans are different from other types of debt because they're secured by valuable assets – your home and your car. While these loans often have lower interest rates than credit cards or personal loans, they're typically your largest debts and require careful management. Today we'll explore strategies to handle these loans effectively and potentially save thousands in interest.

## **Evaluating Refinancing Opportunities**

Refinancing means replacing your current loan with a new one that has better terms. It's like trading in an old phone contract for a better deal – you might get a lower monthly payment or pay less over time. When considering refinancing, look at several factors:

Interest rates: Even a small rate reduction can lead to significant savings. For example, refinancing a $250,000 mortgage from 5% to 4% could save you about $150 monthly and over $50,000 in total interest over a 30-year term.

Loan term: You can choose a shorter or longer term when refinancing. A shorter term means higher monthly payments but less total interest. A longer term reduces your monthly payment but increases overall interest costs. For instance, switching from a 30-year to a 15-year mortgage typically means a higher monthly payment but could save you tens of thousands in interest.

Closing costs: Refinancing isn't free. Mortgage refinancing typically costs 2-5% of the loan amount. Auto loan refinancing usually has lower fees. Calculate your break-even point – how long it will take for the monthly savings to cover the refinancing costs. If you plan to keep the loan longer than the break-even period, refinancing might make sense.

## **Understanding Loan Terms and Prepayment Penalties**

Before making any changes to your loan payments, review your loan terms carefully. Some loans include prepayment penalties – fees for paying off the loan early or making extra payments. These penalties can offset the benefits of refinancing or making extra payments.

For mortgages, check if you have a conventional, FHA, VA, or other type of loan. Each type has different rules and refinancing options. Also, understand if your rate is fixed or adjustable. Adjustable-rate mortgages (ARMs) start with lower rates but can increase over time, making refinancing to a fixed rate worth considering.

For auto loans, verify if your interest rate is simple or precomputed. With simple interest, extra payments reduce your principal and future interest charges. With precomputed interest, the total interest is calculated upfront, so extra payments might not save you money.

## **Strategies for Extra Principal Payments**

Making extra payments toward your principal balance can significantly reduce your total interest costs and shorten your loan term. There are several ways to do this:

Monthly extra payments: Add a fixed amount to each monthly payment, specifying that it goes toward principal. Adding just $100 extra monthly to a $200,000 mortgage at 4% could shorten your loan by 3 years and save over $20,000 in interest.

Bi-weekly payments: Instead of making one monthly payment, make half your payment every two weeks. This results in 26 half-payments (13 full payments) annually instead of 12, effectively making one extra payment each year. This simple change could shorten a 30-year mortgage by about 4 years.

Lump-sum payments: Apply unexpected money like tax refunds, bonuses, or inheritance to your principal. A one-time $5,000 payment on a $200,000 mortgage at 4% could save over $10,000 in interest over the loan term.

Remember to specify that extra payments should go toward principal. Otherwise, they might be applied to future scheduled payments instead.

## **Managing Underwater Loans**

An underwater loan means you owe more than the asset is worth. This commonly happens with car loans in the first few years or with homes during market downturns. If you're underwater on your loan, you have several options:

Keep making payments: If you can afford the payments and plan to keep the asset long-term, continue making payments until you build equity. Making extra principal payments can help you get "above water" faster.

Refinance through special programs: Some government programs help underwater homeowners refinance. For example, FHA and VA loans might allow refinancing even when you owe more than your home's value.

Sell and pay the difference: If you need to sell, you might need to bring money to closing to pay off the remaining loan balance. While this isn't ideal, it might be better than keeping an unaffordable loan.

Your next step is to review your mortgage or auto loan statement. Find your current interest rate and loan terms, and check if you have any prepayment penalties. Then use an online calculator to see how much you could save by making extra payments or refinancing. Pick one strategy from this lesson that fits your situation and make a plan to implement it this month.