

The Biweekly Mortgage - Who Needs It?

Have you received an advertisement offering to save you thousands of dollars on your thirty-year mortgage and cut years off your payments? With email "spam" becoming more pervasive as everyone tries to "get rich quick" on the internet, these ads are popping up with troublesome regularity.

The ads promote the "Biweekly Mortgage" and for the most part, do not come from a mortgage lender. Exclamation points punctuate practically every claim:

- No closing costs!
- No refinancing!
- No points!
- No credit check!
- No appraisal!
- Save thousands!
- Cut years off your mortgage!

To achieve these wonderful savings all you have to do is allow half of your mortgage payment to be deducted from your checking account every two weeks. It's easy. Of course, there is a small "set-up fee" and usually a "transaction fee" with every automatic deduction.

Essentially, the ads are truthful in almost every respect.

They just want to charge you money for something you can do on your own for free.

The Basics:

Normally, you make twelve mortgage payments a year. Since there are fifty-two weeks in a year, a biweekly mortgage equals 26 half-payments a year. The equivalent would be making thirteen mortgage payments a year instead of twelve. By applying that extra payment directly to the loan balance as a principal reduction, your loan amortizes more quickly, requiring fewer payments.

You save money. The ads are true.

How it Actually Works:

You cannot simply mail in half a payment every two weeks to your mortgage lender. Since they do not accept partial payments for legal and accounting reasons, the mortgage company would just mail your half-payment back to you.

Instead, the biweekly mortgage company is an intermediary between you and your mortgage lender. They automatically debit your checking account every two weeks for half of your mortgage payment, then place your funds into a trust account. Basically, this is just a holding account for your money. In another two weeks, there is another automatic deduction from your checking account, and so on. When your mortgage payment is due, your funds are withdrawn from the trust account and forwarded to your mortgage lender.

Since you are placing funds into the trust account faster than your mortgage payments are due, you eventually accumulate enough money to make an "extra" payment. The way the cycle works, this occurs once a year. The extra payment is applied directly to your principal balance, which causes your loan to amortize faster, pay off more quickly and save you thousands of dollars.

Potential Problems with the Trust Account

Because your funds are held in the trust account until your mortgage payment is due, there are

potential dangers. Not only are your funds held in this account, but so are the funds of everyone else enrolled in the biweekly program. That is a lot of money.

Most likely, there will be no problems.

However, if there are accounting errors, mismanagement, or even fraud, your mortgage payment might not get made. The first hint of a problem will probably be a phone call or letter from your mortgage lender, but not until after your payment is already late. Since responsibility for making the payment rests with you and not the biweekly payment company, you may find yourself digging into your personal savings to make the payment directly -- even though the biweekly payment company has already collected your funds.

Later you can work out the trust account problem with your biweekly payment company.

The Cost of the Biweekly Mortgage

There is usually a set-up fee that runs between \$195 and \$350, depending on how much sales commission is paid to the individual or company setting up the account for you. You also pay a transaction fee each time there is an automatic deduction from your checking account and sometimes also when the payment is made to your mortgage lender. There may also be a periodic "maintenance fee."

Meanwhile, whoever controls the trust account is earning interest on your money.

Savings of the Biweekly Mortgage

By making principal reductions using the biweekly mortgage program, your mortgage will amortize more quickly, saving you money. How quickly your loan pays off depends on your interest rate and when you begin making the biweekly payments.

On a \$100,000 loan at today's interest rate of eight percent, your first principal reduction would probably be a year from now. Assuming the principal reduction is equal to one monthly payment (\$733.76), you would save \$43,852 over the life of the loan and pay it off almost seven years early.

However, you have to deduct from those savings any amounts you paid in set-up, transaction, and maintenance fees.

No-Cost Alternatives to the Biweekly Mortgage

Instead of hiring a company to manage your biweekly payment, you could accomplish essentially the same thing on your own for free. Just take your monthly payment, divide it by twelve, and add that amount to your monthly mortgage payment. Be sure to earmark it as a principal reduction.

The first way you save is that you do not have to pay any fees to anyone. It's free.

In addition to not paying fees -- using the same example as above -- your total savings on the mortgage would be \$45,904. Plus the loan would be paid off three months quicker than with the biweekly mortgage. The reason you save more is because you are making a principal reduction each month, instead of waiting for funds to accumulate so that you can make one principal reduction a year.

Self-Discipline?

The biweekly mortgage companies claim that homeowners are not disciplined enough to follow through with principal reduction plans on their own. They suggest the reason for setting up the biweekly mortgage enforces discipline upon you, and by doing so, they save you money.

However, in this internet age, banking on line and automatic deductions are readily available. You can set up your own automatic deductions including the additional principal reduction and have it go directly to your mortgage lender. Since the deduction occurs automatically, just like with the biweekly mortgages, self-discipline is not a problem. Once again, you don't have to pay anyone to do it for you and you save even more money.

Conclusion

The biweekly mortgage plans do not really do anything except move your money around and charge you for it. Plus, even though the danger is negligible, you must trust someone else to hold your money for you. If you can do the very same thing for free, plus save yourself even more money by doing it on your own, why pay someone else?

The biweekly mortgage plan - who needs it?

If your goal is principal reduction and saving money, then it is a good plan. If you do it on your own instead of paying someone else to do it for you, then it is a great plan.