



Should I Pay Off My First or Second Mortgage First?

Many homeowners these days have turned to second mortgage or home equity loans in order to finance various wants and needs, things like home improvement projects, college tuition, or vacations. These second mortgages are also secured by the house, meaning if the borrower cannot repay and goes into foreclosure, the lender can try to recover losses from the sale of the property.

So obviously, getting into a second mortgage or home equity loan is a serious matter as it can jeopardize your homeownership if you are not careful. When it comes to paying back these loans, you may wonder which one should take precedence. If you have some extra money that you can put towards repaying your mortgage loans, you should consider the following factors in order to make the wisest decision for your situation.

Prepayment Penalties

Start by examining the terms and conditions of both your first and second mortgage. Check to see if either loan has prepayment penalties attached to it. A prepayment penalty is a fee charged by the lender if you try to pay off your mortgage earlier than the stated terms. Often these penalties only apply for the first few years of the loan, or they may only apply to if you try to refinance. If either of your loans has a prepayment penalty that would be triggered into effect by making extra payments, you should pay down the loan without the penalty first.

Pay Down the Higher-Rate Loan First

If neither of your loans has a prepayment penalty, and both are fixed rate mortgages, you should definitely pay down the loan with the higher interest rate first. Typically the higher rate tends to be associated with the second or home equity mortgage. Say for example, you have a 30-year fixed loan with an interest rate of 6% and you have a 10-year second mortgage with a rate of 9.5%. It will be smartest to make extra payment on the second mortgage first, because you will be saving yourself more money in interest charges than you would by prepaying the 30-year mortgage.

Pay Off Adjustable-Rate Loans First

The decision of which loan to pay off first is pretty simple if both of your loans have fixed rates, but the situation becomes more complicated if you have one or both of the loans are adjustable rate mortgages (ARMs). If you have one fixed rate loan and one ARM loan, generally you should pay down the ARM loan first, because the rate will likely be increasing in the near future. If both loans are ARMs and both rates will be resetting soon and you plan to be in your home for a while, your best option may be to refinance both loans into one new fixed rate mortgage. This will give you stability of payments and eliminate the dilemma of which loan to pay down first. If you are not ready to refinance, you should consider paying off the ARM loan whose interest rate will be rising or resetting first. Be sure to talk with your trusted mortgage lender or financial advisor if you have more in-depth questions.