New Ideas in Banking

Banks are getting more creative with their loan policies, and consumers can be the beneficiaries.

A bank in Connecticut, has devised a painless way for families to save tens of thousands of dollars in interest on their mortgages. The method is so simple it is hard to believe: Make half the monthly payment every two weeks instead of the whole amount every month. *Bonus:* The mortgage is paid off much faster.

Example: A traditional $100,000 mortgage with an interest rate of 12% would have a monthly payment of $1,028.61...for 30 years. The total cost of interest over that period is $270,307.85.

A $100,000 mortgage with payments of $514.31 every two weeks is paid off in 18.9 years. *Total interest cost:* $154,303.70.

The saving in interest is a staggering $116,004.15, and the house belongs to the family, free and clear, 11 years sooner.

There is no gimmick. It all makes sense arithmetically. *The secret:* The principal is paid off far more rapidly when payments are made every two weeks. That is partly because the principal is reduced every two weeks instead of every month. And the faster the principal is paid off, the less interest is paid.

The other key factor: An additional monthly payment is made each year. Twenty-six biweekly payments are equivalent to 13 monthly payments.

In 18.9 years, when the $100,000 biweekly mortgage is totally repaid, a borrower would still owe $75,749.54 in principal on a comparable mortgage paid on a monthly basis.

Bankers like the idea as much as borrowers because it costs the bank nothing and gives it greater flexibility. It gets its principal back far more quickly, enabling it to use the funds recouped for making new loans.

The idea was introduced by City Savings Bank of Meriden, Connecticut. The bank's chairman, R.K. Montgomery, said that practically all mortgages issued by City Savings are being written on the biweekly-payment basis. In recent months he has received inquiries about the new mortgage from 275 banks in 47 states.

Other lending ideas are coming from California. There, banks are introducing car loans with small—or no—down payments and relatively low monthly payments. The plans generally are designed for people who want to buy expensive cars, although Security Pacific National Bank sets a minimum car price of only $12,000. Bank of America's plan, however, caters particularly to buyers of high-priced autos such as Cadillacs.

These loans are commonly known as "balloons" because very little principal is repaid in the monthly installments. Most of the principal comes due when the loan matures. Thus, the principal "balloons." When the loan matures, the borrower has three options: Paying off the residual value of the car and keeping it, walking away and leaving the car with the bank, or trading the car in for another, under a similar financing plan. At Security Pacific, there is a $200 charge for turning the car in.

Example: You buy a Honda Accord for $13,000 and finance it over 48 months at, say, 15¼%. Security Pacific calculates that the value of the car after four years would be $5,850. That is the figure you would pay at that time to keep the car. In the meantime, if you make no down payment, you pay $280 a month on the loan. In contrast, the monthly payments on a conventional 48-month auto loan would be $363. On the balloon loan, if you put down 20%, the monthly payments are reduced to $203. There are restrictions on how many miles you can drive each year without incurring a mileage charge, and the car must be in "reasonable condition" if it is turned in at the end of the period.

Because of the low monthly payments, balloon loans enable many more people to have expensive cars. Bank of America figures that monthly payments on a $23,650 loan—at 15% interest—would be $489.97. This compares with $658 for a conventional auto loan. A similar balloon loan for $34,350 would have monthly payments of $685.02, compared with $955.96 for a conventional loan.