FACT SHEET

SIMPLE INTEREST

Simple interest loans or financings are made up of two important parts: principal and interest. Principal is the amount of money you borrow for your purchase (including any amounts for voluntary protection products) while interest is the charge paid for borrowing that money and repaying over time.

With this type of financing arrangement, interest is calculated at preset intervals based the outstanding principal at that time. At the start of the contract when principal is greater, the interest assessed is greater, but interest charges will be less over time as the principal amount is reduced.

Your payment schedule set at the start of your contract is based on payments being made exactly on each due date. If you pay on the scheduled date then you'll pay the exact amount of interest disclosed in your contract. If your payments are made earlier or later than the scheduled due dates, your actual interest assessments will also then vary.

Interest on a simple interest loan is usually calculated by using the *simple daily interest*[1] method. This means that interest accrues on a daily basis based on the outstanding principal as of each day. Interest is not compounded, meaning accrued interest is not added to your outstanding principal (though it is added to your total balance).

The simple daily interest method counts the number of days between the date that the last payment is received and the date the current payment is received.

Simple interest can be calculated by multiplying the daily interest rate[2] by the principal by the number of days that elapse between payments. This is the formula:

Principal x Daily Interest x Number of Days Between Payments = Simple Interest

This means that on a simple interest loan, you pay marginally less over time if you pay your loan a few days early each month. Since simple interest is calculated daily, auto finance statements and mortgage statements that use simple interest will often give an approximate payoff amount on the statement, but indicate that the actual payment amount may differ, depending on the day

[1] "Simple daily interest" is a term used interchangeably with "daily simple interest."
[2] Daily interest rate is the APR divided by the number of days in the year. Some creditors may use as few as 360 days for the purposes of this calculation, even though there are 365 days in a year, except for leap years.

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of final payoff.

Mortgage:

On a **simple interest** mortgage, the **daily interest** charge is **calculated** by dividing the **interest** rate by 365 **days** and then multiplying that number by the outstanding mortgage balance. If you multiply the **daily interest** charge by the number of **days** in the month, you will get the monthly **interest** charge.

Make one extra payment per year. Some people who are paid every other week set up a ½ mortgage payment to be withdrawn every time they are paid. As long as both half-payments are made by the actual due date, this practice will reduce the interest paid on a simple interest loan in two ways: 1) the ½ payment that's made ½ month early reduces the total interest paid over time because it's being paid early; and 2) there are 26 pay periods in a year if one is paid every other week, so after one year of paying this way, an entire extra payment has been paid toward principal.

Automotive:

The way simple interest vehicle financing works means a consumer has the opportunity to save and potentially pay off their loan quicker. Here are three ways this can work.

- *Pay early* – Making monthly payments before the due date means less interest will have accrued than if you had paid on time. More of your payment will go toward principal as a result.

- *Pay more frequently* – More frequent payments, such as breaking the monthly installment in two and paying half twice a month (as long as the first one is before the due date and the second is on or before the due date), also reduces the interest due.

- *Pay some extra* – An additional lump sum, or adding to your monthly payments, is another way to pay down principal faster and save on interest costs. (Make sure check with your own creditor on how to make a principal reduction.)

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