How Simple Interest Contracts Work

Your auto loan with Exeter is known as a "simple interest" loan.

Simple interest is an accrual method used to determine the amount owed. Interest is the rate charged for the money financed, or in other words, the cost of borrowing.

HOW SIMPLE INTEREST WORKS

Simple interest is calculated based on the outstanding principal balance, with interest accruing daily.

The number of days between payments determines the amount of daily interest to be collected, regardless of the scheduled due date. When you make a payment, your payment first goes towards the interest owed during the time elapsed since your last payment, and the remaining balance is applied to the principal.

As you pay more towards your principal, not only does the total balance go down, but the amount of interest you're paying on the remaining balance also decreases.

COOL, BUT WHAT DOES THAT MEAN?

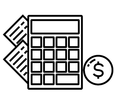
Look at it this way:

- By paying early, you reduce the interest for that payment period by reducing the number of days between payments
- By paying on time, your payment remains fixed each month as outlined in your loan agreement
- By paying late, more interest accrues each day that you are late, and more of your late payment goes towards the newly added interest rather than the principal. Paying late or making partial payments can extend the time it takes to pay off the loan.

HERE'S HOW YOUR DAILY INTEREST IS CALCULATED:

Let's say you have a $20,000 loan at 20% interest

Your principal is multiplied by your interest rate and divided by 365 (number of days in a year) to obtain your daily interest amount.



P = 20,000

I = 20%

Y = 365

(P x I) / Y = your daily interest

In this case, (20,000 x 0.20) / 365 = $10.96/day. You pay $10.96 per day in interest for the first pay period until the principal balance is reduced with your first payment.

HERE'S WHY THAT'S IMPORTANT

IMAGINE YOU ARE TEN DAYS LATE ON YOUR PAYMENT

That means you are paying $109.60 in additional interest (at $10.96/day x 10 days). When you make your payment, an extra $109.60 is going towards the additional interest rather than the principal balance. This means more of your next payment will go towards interest because your remaining principal balance is lowering slowly. This cycle will continue if the principal is not "caught up."

In other words, late payments, missed payments, payment extensions, and due date changes all cause additional interest to accrue each additional day between payments and may result in additional payments owed on the back end of the loan term.

NOW IMAGINE IF YOU PAID TEN DAYS EARLY

That same $109.60 (at $10.96/day x 10 days) would reduce the principal balance instead of going toward interest. If you keep this up and continue to pay early or pay more than your monthly payment owed towards the principal, you will pay off the loan faster and pay significantly less in interest as well. Yep, that's right!

You could SAVE money and pay off the loan early and with no penalty for doing so.

Note:
Accrued interest must be satisfied before any amount will be posted to the principal balance. If the interest has accrued above the amount of a normal payment, the entire payment will go towards interest, and the interest remainder will be added to what accrues during the next span between payments.

Paying early will reduce the interest accrual for that payment, however, if you pay according to the schedule the next month, the days elapsed between payments will be greater, thus increasing the interest out of that payment.

Once a payment is received and the interest is satisfied, the simple interest calculation and accrual begins again on the following day, taking into account the reduced principal.