Demystifying MORTGAGES

– IT'S A – MONEY THING®

Buying a home is likely the biggest purchase of your life, and you'll usually need a loan to make it happen

Comparing mortgages can be confusing and intimidating—let's break it all down so you can understand how it works

3% APR

When shopping for a mortgage, financial institutions have products with an advertised APR, which stands for Annual Percentage Rate.

But the APR doesn't tell the whole story—make sure to understand the type of mortgage being promoted. Plus, there are a wide range of additional costs to consider, including insurance, taxes, admin fees and any penalty fees that may apply.

You'll need to decide between a fixed-rate and an adjustable-rate mortgage

ADJUSTABLE RATE An adjustable-rate mortgage (also known as a variable-rate mortgage) is based on a chosen index, so it changes throughout the term of your loan. The index is a benchmark that reflects changes in the national economy.

ADJUSTABLE

If the index goes up, so does your rate and the amount of your payment. If the index goes down, so does your rate and the amount of your payment.

FIXED RATE In a fixed-rate mortgage, the interest rate is set when you take out the loan and it does not change over time. The amount you pay monthly will stay the same for the entire term of your loan.

FIXED

It's a trade-off

Fixed-rate mortgages are consistent and easier to budget for, but tend to have higher interest to counter the effect of rates rising in the future.

Adjustable-rate mortgages usually have a lower advertised start rate, which is very appealing, but can be unpredictable and harder to budget for.

Think about your income, your future, how long you plan to live in the home and your risk tolerance before deciding which type of mortgage is right for you.

How does the mortgage repayment work?

An amortization schedule is how your loan repayment is broken down into regular installments over the term of the loan.

The schedule shows you how much of each payment is going towards interest and how much of it is going towards the principal.

PAYMENT → INTEREST
PAYMENT → PRINCIPAL

— FOR EXAMPLE —

Let's say you have a $150,000 fixed-rate mortgage with a 3% annual interest rate amortized over a 25-year period. Your payment will be $711 per month.

25-YEAR MORTGAGE
$150,000
3% APR, FIXED

$711 per month

The monthly payment for a fixed-rate mortgage is the amount paid by the borrower every month that ensures that the loan is paid off in full with interest at the end of its term.

This is how the interest is calculated for each payment

TOTAL OWING	INTEREST RATE	ANNUAL INTEREST	MONTHS IN A YEAR	INTEREST IN CURRENT PAYMENT
$150,000 x 3%	= $4,500	÷ 12	= $375	

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In your first payment, $375 will go towards interest and only $336 will go towards your outstanding balance. So even though you've made a payment of $711, your balance has only decreased by $336.

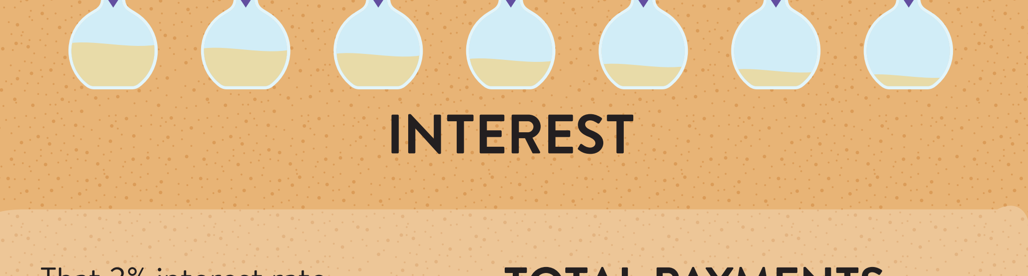
$375 INTEREST ← $711 PAYMENT → $336 PRINCIPAL

The following month, because your outstanding balance is now $149,664, the interest portion of your monthly payment will be slightly lower and the principal portion will be slightly higher.

$149,664 x 3% = $4,490 ÷ 12 = $374

A big chunk of your monthly payments go towards interest at the start of the term. Over time, more of your payment will go towards the principal than towards interest.

PRINCIPAL



INTEREST

That 3% interest rate may not seem like much, but after 25 years, you will have made $213,395 in payments on your $150,000 loan!

TOTAL PAYMENTS
$213,395
AFTER 25 YEARS

Understand before you sign

People get into trouble by committing to mortgages they don't understand. All the more reason to know exactly what you're getting into before signing anything.

A mortgage can be an empowering experience or a burden. It all comes down to your understanding of the mortgage products available, honesty regarding your personal finances and clarity about your life situation.

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Sources: Amortization-Calc.com, United States Department of Labor (Bureau of Labor Statistics)

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