Mortgage Amortization

- Amortization is the technical term for how your mortgage is paid off over time and determines the amount of your monthly mortgage payment
- Except for interest-only mortgages, all mortgages amortize, which means the vast majority of mortgages amortize
- For amortizing mortgages, the mortgage payment is split between principal and interest
    - The principal component of your mortgage payment goes to paying down the mortgage balance
    - The interest component of your mortgage payment represents the cost of borrowing money from the lender and does not reduce your mortgage balance
- The split between the principal and interest payments that make-up the monthly mortgage payment is determined by a mathematical amortization formula
- You pay a monthly mortgage payment, based on the formula, that will pay down the mortgage balance completely and pay the lender the required amount of interest, over the life of the mortgage
- Even though your monthly mortgage payment may not change over the life of the mortgage, the split between principal and interest changes a little bit every month
- At the beginning of your mortgage, most of your monthly payment goes to paying interest. At the end of your mortgage, most of your monthly payment goes to paying principal
- A fixed rate mortgage has a constant payment over the life of the mortgage, but the principal component represents an extremely small percentage of the monthly mortgage payment for the majority of the mortgage
- For a 30 year fixed rate mortgage, it takes approximately nineteen to twenty three years to pay down half of the mortgage, depending on the interest rate
    - The lower the interest rate, the faster the principal reduction
- Understanding how amortization works is key knowing how much of your mortgage you have paid off and how much equity you have in your home at any give point over the life of your mortgage
- The chart below shows how amortization works for a $380,000, 30 year fixed rate mortgage with a 4.0% interest rate
- This example illustrates how at the start of your mortgage, the majority of your monthly payment goes to paying interest while at the end of your mortgage, the majority of your payment goes to paying principal. The chart also demonstrates how the principal balance of your mortgage declines to zero over the term of the mortgage even though your monthly mortgage payment does not change