Mortgage Basics

Many people dream of owning their own home, but the high cost of homes generally requires a home mortgage to make this become a reality.

On this page, we discuss some of the basic terms and concepts related to mortgages.

Mortgage Terminology

A **mortgage** is a loan you obtain to pay for a home and any land it sits on. The home and land is used for collateral on the loan, which means that if you don't make your payments, the lender can take the home away to cover your missed payments.

The loan **principal** is the amount you actually borrow to purchase the home.

Interest is the amount the bank charges you to use their money; it is a percentage based on current economic indicators.

Because the loan is for such a high amount, it is usually financed for between fifteen and thirty years. The amount of time is called the loan's **term**. Principal and interest together comprise most of your payment.

The total is then divided into equal payments over the life of the loan using a process called **amortization**. With amortization your payments mostly go toward interest early in the loan and then more goes toward the principal later in the life of the loan.

For example, if you borrow $100,000 dollars with a 30-year loan at 7% interest, amortization will calculate your payments something like this:

Payment	Amount	Interest	Principal	Balance
First Payment	$665	$583	$82	$99,918
At 5 Years	$665	$550	$115	$94,132
At 10 Years	$665	$501	$164	$85,812
At 20 Years	$665	$336	$329	$57,300
Last Payment	$665	$4	$661	$0

In this example, after thirty years you would have paid off the $100,000 you originally borrowed, but you also would have paid an additional $139,509 in interest.

Your total payment is more than just the principal and interest. The acronym PITI can help you remember all the parts of your payment. It stands for principal, interest, taxes, and insurance.

If you put less than twenty percent down on the loan, the bank considers it a little riskier and requires an escrow account. They pay your annual insurance and taxes from this account and collect money monthly to gather the required amounts.

If you have less than twenty percent down, your lender will probably also require you to include an amount for private mortgage insurance (PMI) in your payment. These are then added to the required principal and interest amounts to total your monthly payment.