Mortgages Explained

Basically, a mortgage is just a loan that is to be used to finance the purchase of property. The property itself is used as security to ensure repayment and the lender holds the title or deed to the property either directly or indirectly (depending on your jurisdiction and type of lender) until you have repaid the entire amount plus interest.

When shopping for a mortgage you should keep in mind that there are many different types available. They can range from fixed rate mortgages where the interest rates never change, to adjustable rate mortgages (ARM's) where interest rates are pegged to some type of market index, allowing them to rise or fall over time as the economy changes. Between these two extremes are a variety of other products that attempt to blend the advantages of the guaranteed interest rates of fixed rate mortgages with the flexibility found in adjustable rate mortgages. The length, or "term" of a mortgage, is also an important factor to consider. You can choose between short-term mortgages that need to be renegotiated every few years (called "balloon" mortgages), and long-term mortgages where you lock your loan in for up to 30 years.

One of the most important things you need to do before committing to any type of mortgage is to sit down with a mortgage professional and examine the advantages and disadvantages of all available options and determine which product is best suited to your current situation and future plans.

The Basic Components Of A Mortgage:

1. Mortgage Amount:
The total amount of money to be borrowed by the Purchaser and applied toward the price of the property. In general, the mortgage amount plus down payment equals purchase price.

2. Down Payment:
The amount of money provided by the Purchaser toward the purchase price of the property (not including legal fees or other acquisition costs). In general, down payment plus mortgage amount equals purchase price.

3. Interest Rate:
The actual cost of borrowing money, charged as a percentage of the outstanding amount owed. Usually compounded on a monthly basis.

4. Term of the Mortgage:
The period of time during which the loan contract is active. During this period the borrower makes periodic payments (usually monthly) to the lender and at the end of the term the balance of the loan becomes due and payable.

5. Amortization Period:
The period of time after which, if all monthly payments are made on time and in full, the loan will be paid out. The term and the amortization of a mortgage are often the same, but do not need to be. Instead of having a 30-year mortgage term with a standard 30-year amortization, the borrower could opt for three 10-year terms (called balloon mortgages). At the end of each term the borrower would have to refinance the loan, necessitating renegotiation of the interest rate and payment schedule with the lender.

6. Discount Points:
Discount points refer to the additional money the borrower may pay to the lender on closing to get a lower interest rate on the loan. The cost of one point equals 1% of the amount borrowed. This means that one point on a $150,000 mortgage equals $1,500. Usually, for each point paid for on a 30-year loan, the interest rate is reduced by about 1/8th (or 0.125) of a percentage point.

7. Prepayment Privileges:
The right of the borrower to pay out all or part of the outstanding principal before it comes due. These privileges are usually set out in the initial mortgage negotiations between the borrower and lender and will differ depending on the type of mortgage.