Understanding Your Monthly Mortgage Payment

When you get a mortgage to buy a home, it's important to understand the breakdown of your monthly statement. This will help you keep track of your finances, and to help you figure out your timeline of when you should be able to pay off your home loan.

This article will break down the different components of a typical monthly mortgage payment to help you better understand what you're paying, why you're paying it, and for how long.

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Your monthly mortgage payment is not just paying off your mortgage. Luckily there's a handy acronym to help you remember what's all incorporated in your monthly mortgage payment—**PITI: Principal, Interest, Taxes, and Insurance.**

Let's take a look at each of these parts in greater detail.

Principal & Interest

Principal

Your mortgage principal is the total amount of money you're borrowing – the price of the home minus your down payment.

If you buy a $400,000 house with a 20% down payment of your own money ($80,000), your starting principal balance is $320,000. Every time you make your mortgage payments, this principal amount is reduced.

Interest

Interest is the amount you pay your lender for borrowing the money. The interest rate on your loan is dependent on what's going on in the market at the time your loan is secured, and is impacted by many factors like your credit history, debt-to-income ratio, down payment amount, loan term, and loan amount.

How Are Principal And Interest Payments Calculated?

Although your total principal and interest payment will be the same each month, the principal and interest distributions change over time as your loan amount gets paid down. Your **amortization schedule** is the breakdown of how principal and interest is applied to your loan each month for the duration of your loan term.

For example, let's say you have a $320,000, 30-year mortgage loan with a fixed interest rate of 5%. Your total

principal and interest payment is $1,718 every month (for this example we are excluding any taxes and insurance).

For your first payment, $384.50 will go toward principal and $1,333.33 will go toward interest. Your original loan amount of $320,000 is now reduced to $319,615.50 after this first principal payment is applied.

For your second payment, you'll still be paying $1,718 for principal and interest. However, your distribution is now based on the loan amount of $319,615.50 instead of $320,000. This means more of the monthly payment goes to paying down principal and less to interest.

This continues month after month until you reach a $0 balance on your loan. This helps explain how your P&I payments are applied to your loan. You'll see this information on your monthly statement as well.

There are many amortization schedule calculators available for you to calculate your own scenarios.

Taxes

Property taxes are used to pay for schools, fire department services, police services, etc. within your community. You may owe these taxes annually, quarterly, or semi-annually.

Instead of taking on the responsibility of saving money to pay these taxes as they come due, your mortgage servicer will establish an **escrow account** to cover reoccurring, non-mortgage expenses like property taxes and howeowners insurance. When the bill is due, your lender pays it on your behalf out of your escrow account.

Insurance

The last guaranteed piece of your monthly payment is insurance. Everyone who buys a house must have homeowner's insurance. This helps protect your home in the event of a disaster or accident (like a fire, tornado, or a hail storm).

Like with your taxes, your mortgage servicer will set aside a portion of your total monthly payment into your escrow account for homeowner's insurance payments and then pay them on your behalf as they're due. Your lender can provide you recommendations for homeowner's insurance providers, but it's ultimately up to you to choose your insurance company and policy.

Other Fees

Mortgage Insurance

If you don't put 20% down when you purchase your home with a conventional loan, you'll be required to pay **Private Mortgage Insurance (PMI)** each month. PMI drops off automatically when your principal balance reaches 78%, but you may request it to be removed yourself once it hits 80%.

If you get an FHA loan, the insurance structure is a little different. Since the down payment on this type of loan can be as little as 3.5% of the total purchase price, Mortgage Insurance Premiums are required for all FHA loans. MIP is calculated every year and is paid once a month.

More information on FHA Mortgage Insurance Premiums can be found on fha.com.

Homeowner's Association (HOA) Fees

An HOA fee goes to maintaining the property and shared facilities or services that are part of certain private residential communities like condos, townhouses or gated communities. These are fees that are usually paid monthly (sometimes quarterly) to your neighborhood homeowner's association.

Conclusion

There are many types of mortgages and they all charge different monthly payment amounts. But don't make the mistake of choosing a mortgage just because it has the lowest monthly payment. If you want to build wealth that lasts, focus on total cost.

At NEO Home Loans, we make sure that you completely understand every component of your monthly mortgage payment. We will review everything with you thoroughly and disclose every cost you should expect ahead of time, so you don't encounter any surprises when it comes to paying for your home. We will also ensure that you are in the right mortgage program that will best help you meet your financial goals.

If you would like some help understanding just how much your monthly mortgage payment will be, fill out the form below to request a quick conversation with one of our mortgage advisors.

Want to learn more? Please schedule a call today!

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