## Translate amortisation into big savings

When you apply for a home loan, you will definitely hear about “amortisation”, and it’s important to understand how this works because it’s actually the key to good management of your mortgage.

“In simple terms, amortisation is the process of paying off a debt or a loan over a set period by making monthly payments that are each made up of two parts, the principal repayment and the interest repayment,” says Shaun Rademeyer, CEO of BetterLife Home Loans, SA’s biggest mortgage originator.

“The principal portion of the monthly total goes towards repaying the original amount you borrowed (the capital), while the interest portion obviously goes towards paying off the interest the bank is charging you in order to lend you the money.”

He explains that the interest on amortised loans is charged in arrears, and is totalled up every month-end based on how much of the original loan is still outstanding. “So for example on a R1m loan on which the bank is charging you 9,25% interest a year, the interest due at the end of the first month would be R7 708 and this would make up the interest portion of your monthly instalment

“However, you are of course also expected to start paying back the actual loan, so your total instalment would actually be R9 159, with R1 450 of that being the principal portion.”

Thus by the end of month two, both the capital amount outstanding and the interest due would be slightly lower, with the result that the principal portion of your monthly repayment would be slightly higher. In other words, although your total monthly instalment remains the same, the ratio of principal to interest in that instalment changes each month. (To see how this works, put your own home loan numbers into one of the many amortisation calculators on the Internet).

And this ratio, says Rademeyer, will continue to change according to a set pattern - even if the interest rate goes up or down – so that you can be certain of paying off both the capital and the interest charged within the agreed loan period.

“It does mean, though, that the rate at which you gain equity in your home is very slow in the initial years of your mortgage, because most of your money each month is going towards paying off interest.”

But, he notes, you can change that, and save many thousands of rands worth of interest, by paying an additional amount each month to reduce the total capital outstanding. The effect of this is to reduce the amount of interest due each month and change the principal / interest ratio of your regular instalment in such a way that the home loan is paid off much faster.

“On our R1m loan taken over 20 years at an interest rate of 9,25%, for example, an additional R500 a month paid off the capital from the first month would cut the loan period by almost three years and, thanks to the power of compound interest, generate savings for the borrower of R185 000.”

*If you would like more information about achieving savings like this, and obtaining a home loan at a rate that could enable you to save even more, contact your BetterLife home loan consultant today.

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