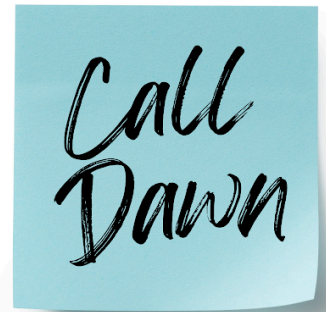




Amortization Explained

Amortization is the gradual reduction of a debt over time. The word originates from Latin and French roots where "mort" implies death or end. In finance, amortization refers to how a loan is systematically paid off through regular payments, combining interest and principal.



Amortization Schedule

An amortization schedule outlines how each payment reduces both the interest and the loan's principal balance over time. Each payment progressively decreases the loan balance, with calculations typically going like this:

1. **Calculate interest:** Multiply the current balance by the interest rate and divide by 12.
2. **Determine principal paid:** Subtract the calculated interest from the monthly payment.
3. **Update the balance:** Deduct the principal paid from the previous balance.

Fixed-Rate vs. Adjustable-Rate Mortgages (ARM)

- **Fixed-Rate:** The loan's monthly payment is pre-set for its entire term. Paying extra reduces the principal faster, saving on interest.
- **ARM:** Payments adjust periodically based on interest rate changes. Extra payments towards the principal can help cushion the impact of interest rate hikes.

Non-Amortizing Loans

Some loans have exceptions:

- **Interest-Only Loans:** These involve only paying the interest without reducing the principal.
- **Negative Amortization Loans:** The payment is so low that it doesn't cover the accruing interest, causing the loan balance to grow.

Recasting

Some fixed-rate loans have a re-amortization or "recast" option, allowing borrowers to pay a lump sum and request a recalculated monthly payment to reflect the new balance.

In essence, amortization allows a borrower to steadily pay down debt while balancing both interest and principal. Different loan structures impact how payments work and whether they reduce the loan balance consistently or not.

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