

AMORTISING MORTGAGE DEBT

Mr Negri has to decide whether to repay his mortgage debt directly or indirectly, how does it work?

Francesco Canonica, mortgage specialist at Assidu SA, replies:

1. Direct amortisation:

means reducing the mortgage principal. Therefore your quarterly payment includes repayment of the principal as well as the interest. The sum of the mortgage debt is thus reduced year on year.

Example:

a mortgage debt of CHF 600,000 is paid back at CHF 6,000 a year. Over five years the debt will be reduced to CHF 570,000 (CHF 6,000 x 5 = CHF 30,000).

Advantages:

annual reduction in interest payments. After five years you are liable for interest on a residual sum of CHF 570,000 instead of CHF 600,000.

Disadvantages:

reducing annual interest payments also reduces your tax-deductible income, thus increasing your taxable income so you have to pay more tax every year.

2. Indirect amortisation:

does not directly reduce the principal, instead you set the funds aside in the 3rd pillar (with an insurer or bank) to repay the debt. This means the sum of the mortgage debt is not paid back in instalments, instead the debt is settled through one payment at the end of the set term.

Example:

the mortgage debt of CHF 600,000 is reimbursed by setting up a pledge through a 3rd pillar involving an annual payment of CHF 6,000 over a 15-year term. The debt shall be reduced by a further CHF 90,000 over this term (CHF 6,000 x 15 + interest and/or participation in profits).

Advantages:

reduction in taxable income leading to a lower tax burden. If you take out a 3rd pillar with an insurer, you can benefit from an insured sum in the event of death and a pension in the event of disability. You could also make up any shortfalls in pension provision to offset any early withdrawal of your pension assets.

Disadvantages:

no annual reduction in interest payments.

(to follow)

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Summary:

Amortisation	Mortgage debt	Mortgage interest	Taxes
<u>Direct</u>	reduced	reduced	increased
<u>Indirect</u>	unchanged	unchanged	reduced