

Your Step-by-Step Mortgage Guide



One of the first steps in buying a new home is to take a realistic look at what you can afford and how you are going to pay for it. If you are like most people, you will probably have to finance your home purchase with a mortgages loan. What follows is an explanation of terms and options to understand when considering what mortgage is right for you.

What is a mortgage?

A mortgage is a loan that uses the home you buy as security. This loan is registered as a legal document against the title of your property. Here's a quick overview of some of the most common aspects of a mortgage that you need to understand.

Mortgage Terms

- Principal
- Interest
- Amortization Period
- Term
- Maturity Date
- Payment Schedule

The **Principal** is the amount of the loan, or the cash borrowed.

The **interest** is the amount the lender charges for the use of funds, or principal. Interest rates vary according to many factors, including terms and conditions of the mortgage as well as a borrower's credit history. Mortgage payments are usually applied toward both principal and interest.

The **amortization period** is the actual number of years that it will take to repay the entire mortgage loan in full. This normally ranges from 15 to 25 years but can be extended in certain circumstances. A longer amortization period will result in lower payments but it will take that much longer to pay off your mortgage which in turn means you will pay more interest. You should select the shortest period you can afford.

The **Term** is the length of time for which a mortgage agreement exists between you and your lender. Typically, terms range between six months and ten years. A longer term means you will keep the interest rate agreed upon for that longer length of time. Rates vary with the term and the difference in payments and interest costs can be calculated by your mortgage professional. Once your term is up for renewal, you can reevaluate your financial situation and consider new term and amortization periods.

The **maturity date** marks the end of the term, when you can either repay the balance of the principal or renegotiate the mortgage at interest rates in effect at that time. If you should choose to repay the balance or renegotiate the mortgage before this date, penalties may be charged.

Payment schedule is the frequency at which you will make your mortgage payments. These can occur monthly, semi-monthly (twice a month), biweekly (every other week), or weekly. Generally, more frequent payments can result in lower interest costs over the life of your mortgage.

A \$400,000 purchase with 5% (\$20,000) down payment based on 5 year term and 3.09% interest at 25 yrs, payments would look like below.

The 25 year amortization results in \$1498 more interest paid in the first 5 years alone. This is because more of each payment goes to interest and less to the principle despite the payments being less.

Example:

A \$400,000 purchase with 5% (\$20,000) down payment based on 5 year term and 3.09% interest, payments and interest costs would look like this:

AMORTIZATION	MONTHLY PAYMENTS	TOTAL INTEREST OVER 5 YRS
25	\$ 1,873	\$ 56,030
20	\$ 2,188	\$ 54,532

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Some Mortgage Options

- Open vs. Closed
- Fixed, Variable or Adjustable Interest
- Portability
- Prepayment



Some Mortgage Options

- Conventional Mortgages
- High Ratio Mortgages
- Mortgage Insurance
- Sources for Down Payments

Mortgage Options let you tailor the mortgage to fit your personal needs and circumstances. Open or closed mortgages, pre-payment options, fixed or variable rates or portable mortgages are just a few of most commonly available options.

Open vs. Closed: *Open*, describes the option to prepay without penalty allowing a borrower to make large lump sum payments or pay off the entire mortgage without incurring extra fees. This option generally comes with higher interest rates and shorter terms. This is a good option if you plan on selling your home soon, or need a short period of time to weigh your options before locking into a closed mortgage.

Closed, may set a limit on the amount of frequency at which lump sum payments are allowed. Should you choose to pay off your mortgage before the end of term you will most likely be charged a penalty. As such they are not a good option if you plan on moving in the near future. They do however involve fixed payments allowing a homeowner to adjust to a new budget that now includes regular payments. Also, terms are normally set for longer periods allowing for greater certainty when planning for the future.

Fixed vs. Variable Adjustable: *Fixed*, describes an interest rate which will not change over the term of the mortgage. This will result in regular payments even if interest rates change. This is a good option when interest rates are low and are expected to rise in the near future. It also gives a first-time homeowner time to adjust to any change in budget that making mortgage payments may have caused.

Variable, means that the interest rate being charged is changing based on the interest rate set out by the Bank of Canada. This rate fluctuates based on market conditions. Your payments will, with few exceptions, continue to stay the same however the amount you are paying will be distributed to the interest and principal in different amounts. If interest rates rise you will be paying off less of the original borrowed sum as more of your payment goes to interest. The opposite being true should interest rates drop. If you have a fair bit of flexibility in your budget, this may be a good option as variable rates over the life of your mortgage often result in lower interest charged.

Adjustable, as with the variable option above, interest rates will change with market conditions, however any change in interest rate will result in an increase or decrease in payment. This option should be considered with great care as an increase in rates could result in payments outside your budgetary limits.

Your mortgage professional can help you decide which option is best for you by talking to you about current market conditions and expectations on future rate changes, as well as the risk you are willing to assume within your personal budget.

Portability: Main lenders offer products which will allow you to carry your current mortgage conditions to a new home should you decide to move. Should you require an insured mortgage due to a high ratio loan (see below), there are options for portability on the insurance that may eliminate any application fees should you require insurance for your new home. This feature requires approval from the lender.

Pre-payment: Regardless of the type of loan (fixed/variable, term, amortization) most lenders will have guidelines that will allow you to pre-pay a portion or percentage of your mortgage in advance of the end of the term. Such conditions often include an option to double up a payment or pay an extra 10-20% each year on the amount of principal borrowed. These conditions should be considered with care should you anticipate any ability to make larger mortgage in the future. Pre-payments can make a drastic difference to the interest incurred over the life of the mortgage as they are applied only to the principal amount and not divided between principal and interest as your regular monthly payments will be.

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Types of Mortgages

There are two basic types of mortgages:

Conventional Mortgage: The loan amount does not exceed 80% of the property value, defined as the lesser of the purchased price or the appraised value. If you are buying a home as a rental property you will be required to have a minimum down payment of 20%, resulting in a conventional mortgage.

High-Ratio Mortgage or National Housing Act mortgage: The principal amount is more than 80% of the property value up to 95%. By law, a high-ratio mortgage must be insured against borrower default (the borrower not being able to make mortgage payments). The borrower pays a mortgage insurance premium (a percentage of the total loan amount) which can be added to the mortgage loan if paid in a lump sum in advance. The borrower must also pay an insurance application fee.

Under the STRESS TEST RULES (Oct 2016) we have to qualify all these mortgages using the Bank of Canada Posted Rate (Currently 4.64% March 2017)

Example:

With a property value of the home at \$400,000 and 80% being the upper limit for conventional mortgages the loan would be \$320,000. If the mortgage was any larger it would be considered High-ratio.

Example:

Property value & purchase price of the home \$400 000,
Mortgage loan amount \$350 000.
 $350,000/400,000 \times 100\% = 87.5\%$

Since the mortgage loan amount is more than 80% of the property value the loan will need to be insured. At today's rates (May 2014) mortgage insurance would cost \$8,400, 2.4% of the borrowed amount. Please see the CMHC table below for applicable rates. This amount could be paid up front or added to your mortgage to make the total loan amount \$358,400.00

Mortgage Insurance

There are various organizations that offer mortgage insurance. Certain lenders will have a preferred organization that they may use exclusively. There are also programs offered by mortgage insurance companies that include vacation properties, new to Canada buyers, energy efficiency rebates, and more.

APPLICABLE PREMIUMS (OWNER-OCCUPIED PROPERTIES)	
LOAN TO VALUE RATIO	PREMIUM ON TOTAL LOAN AMOUNT
Over 80% Up to and including 85%	2.80%
Up to and including 90%	3.60%
Up to and including 95% Traditional down payment	4.00%
Non-traditional down payment	4.50%



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Sources of Down Payment: There are various sources available for your down payment. Below is a list of traditional sources and non-traditional sources. Non-traditional sources, although available, may come with higher interest rates or required insurance as noted in the table above. Make sure to talk to your mortgage professional about the implications of these sources.

TRADITIONAL SOURCES	NON-TRADITIONAL SOURCES
Borrower's Savings	Cash back from lender
RSSP withdrawal	100% sweat equity
Non-repayable gift from immediate family member (gift letter required)	Borrowed Funds
Funds borrowed against proven assets	
Sweat equity (<50% of minimum required equity)	

STEPS TO A SPEEDY APPROVAL

The more information and supporting documentation you can provide your mortgage professional up front, the more likely your approval process will be completed quickly. Filling out an application online can help ensure your mortgage professional gets all the necessary details. If you don't have access to a computer, call to request a paper copy or set up a meeting.

Ways to Speed up your Approval-Supporting Documentation your mortgage professional may require:

- Identification
- Proof of Employment
- Down payment
- Housing History
- Credit
- Assets and Liabilities

Identification

- Government issued photo ID (current address)
- SIN Number

Assets & Liabilities

Approval will depend on your ability to afford your monthly payments. Assets such as: balances in saving and checking accounts, RRSP and investments balances, vehicles you own as well as other properties combined with liabilities including: other mortgages, credit cards and loans will decide your ability to make these payments.

Housing History

- 3 years' history of rent paid and corresponding addresses.
- Information on any other properties you own
- Information regarding the property you plan on purchasing including any monthly strata fees, property taxes, heating source, MLS listing and address (civic and legal), closing costs (usually around an additional 1.5%), Land Transfer Taxes. However sometimes a solicitor letter with closing costs is sufficient.

Down payment

- 3 months of bank statements, savings and /or checking account.
- Most recent RRSP & investment statements, verification of transfer.
- Gift letter for gifted down payment from an immediate family member & confirmation of deposit.
- Source of borrowed funds, ex. Line of Credit/VISA, if qualified.

Most of this information can be forwarded by your realtor.

Employment and Income Proof

- Tax document: T4, TI general/ Notice of Assessment (NOA)
- Pay Stub
- Letter of employment
- Self Employed- 2 years NOA and proof of 2 years' business for self; Incorporations documents or GST number.
- Also ask about new to Canada requirements stating position, income (guaranteed/hours) start date.
- Any other information regarding other sources of income. These can include but are not limited to: settlement payments, disability payments, alimony, government grants: including child tax benefits and bonuses paid by employer or recent changes in such arrangements that could increase your income.