Mortgage Wise

A guide for home buyers

CANADIAN BANKERS ASSOCIATION
Building a Better Understanding

On behalf of the banking industry, the Canadian Bankers Association has embarked on a program called *Building a Better Understanding*. This is our commitment to communicate better and to provide useful financial information to Canadians.

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These publications are also available in alternative formats for people who are partially sighted or have limited vision.

La version française de cette brochure est disponible sur demande.

This booklet gives information of a general nature and is not intended to be relied on by readers as advice in any particular matter. Readers should consult their own advisors on how this information may apply to their own circumstances.

Table of Contents

Introduction . . . . Page 3

The Home Buying Decision . . . . Page 4

Deciding to Buy . . . . Page 4

What Can You Afford? . . . . Page 5

Your Down Payment . . . . Page 11

Don't Forget the Extra Costs . . . . Page 13

The Home Buying Search and Purchase . . . . . Page 15

Finding the Right Home . . . . Page 15

Arranging An Offer . . . . Page 19

Closing the Deal and Taking Possession . . Page 21

Getting Your Mortgage . . . . Page 22

Understanding the Key Terms . . . . Page 22

Shopping for a Mortgage . . . . Page 23

Mortgage Insurance. . . . . Page 29

Applying for a Mortgage . . . . Page 30

Paying Your Mortgage. . . . . Page 31

How to Pay Off Your Mortgage Quickly . . Page 31

Changing the Terms and Conditions. . . . . Page 34

If You Need Help . . . . Page 35

A Final Word . . . . Page 36

Sources of Information . . . . Page 37

Glossary of Terms . . . . Page 38

By doing your homework and carefully weighing all of your options, you can make an informed decision about home ownership.

Introduction

Home ownership may be the biggest investment you'll ever make. That's why it's important to go into it with your eyes wide open.

The first thing to keep in mind is that buying a home is never a simple proposition. Not only do you need to consider your budget, lifestyle and location, you need to look at the many housing and mortgage options. Do you want a new home or a resale property? A detached home, a condo, a townhouse or a mobile home? Is it freehold or leasehold land? What about your mortgage? Do you want it open or closed? Long or short-term? Fixed or variable? Special features like pre-payment options, portability or assumability? What about mortgage insurance? What should you expect from your real estate agent, lender, lawyer, notary, home inspector and builder?

If it sounds complicated, it is. But by doing your homework and carefully looking at all of your options, you can make an informed decision about home ownership. Whether you decide to buy now, later or not at all, the more research you do, the more certain you can be that you've made the right choice.

While the main focus of *Mortgage Wise* is mortgages, it also covers the various issues involved in buying a home. From making the decision to buy, to finding the right home, to the details of your mortgage, this booklet will help guide you through the process.

The Home Buying Decision

Deciding to Buy

Buying a home is an exciting prospect. But before you take that step, there are many things you need to know to make a wise choice. Most important, take your time and do your homework. Decide where you want to live. Monitor the market to see if prices are rising or falling and watch interest rates. The more closely you watch market conditions, the better your chances of getting the best investment for your money.

Learn about the hidden costs of buying a home and the types of mortgages available. If you can't afford a home now, set out short and long-term goals. Remember that having the down payment is just the first step; you need to be sure that you can afford the "extras" and ongoing costs of a home.

Also consider whether buying is, in fact, the right choice for you. We've often heard that buying is always better than renting. From an investment point of view, this isn't always the case. When comparing owning to renting, it's a numbers game: you have to add up all of the figures, including the cost of your home, the size of the down payment you require, utilities, immediate repairs, interest rates and insurance, and compare them to how much you spend on rent.

Of course, you have to look at the enjoyment and satisfaction you'll derive from owning your own home, as well as potential increases in your property's value during the time you own it.

What Can You Afford?

Before you start looking for a home, you need to figure out what you can afford. This means closely examining your finances including income, expenses, investments, savings, loans and debts. If you aren't sure, fill out the charts on pages 5 - 8.

Looking at your financial situation helps you figure out what you can afford in monthly mortgage payments and how much you may want to put towards saving for your down payment. While you're doing this, keep in mind any extra expenses you might incur down the road. In the short term, do you plan on: starting a family? buying a new car? taking a major vacation? getting married? All of these things cost money and will have to be factored into your expenses.

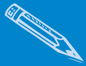
Financially, buying a home comes down to two key things: what you can pay out each month in mortgage payments and other obligations and how much you can afford as a down payment.

Calculating Your Monthly Income

	Total
Salary (after taxes and other deductions)	$
Commissions	
Contracts	
Bonuses	
Tax credit	
Child support/alimony	
Interest income	
Investment income	
Rental income	
Other income	
Total Monthly Income	$

Monthly Expenses

	Total
Fixed Expenses:	$
Rent/mortgage	
Utilities: (if on monthly payment plan)	
Electricity	
Heat	
Child-care expenses	
Cable TV/special channels/Internet	
Service contracts (cleaning/lawn/snow removal/etc.)	
Monthly Savings and Loan Expenses:	
Regular savings	
Car loan payments	
Other loan/debt payments	
Pre-Authorized Contributions:	
RSP	
Alimony	
Registered education fund	
Other	
Irregular expenses:	
Taxes:	
Personal income tax (if not deducted at source)	
Municipal tax (if not included in mortgage payments)	
School tax (if not included in mortgage payments)	
Water tax (if applicable)	
Utilities: (if not on a monthly budget plan)	
Electricity	
Heat	
Insurance Premiums:	
Home/tenant	
Automobile	
Life/disability	
Medical	
Car registration	
Driver's licence fees	



MONTHLY EXPENSES

	Total
Variable Expenses:	$
Car maintenance and repairs	
Gas/oil	
Parking	
Public transportation/taxis	
Dining out	
Groceries	
Dry cleaning	
Clothing	
Babysitting	
Home maintenance/repairs	
Telephone (including cellular and long distance)	
Furniture	
Health:	
Medical/Prescriptions	
Dental	
Recreation:	
Newspapers, magazines, books, videos, dvds	
Alcohol, beer, wine	
Movies, concerts, plays, etc.	
Recreational/club/court fees	
Pets:	
Veterinary bills	
Pet food	
Personal:	
Personal care items	
Hairdressing	
Charitable donations	
Gifts	
Vacations	
Spending money	
Miscellaneous	
TOTAL MONTHLY EXPENSES	$
Total Monthly Income:	
Total Monthly Expenses: -	
CASH REMAINING: =	$

Assets (what you own)

	Total
Chequing account(s)	$
Savings account(s)	
Value of home	
Automobile(s)	
Cash value of life insurance	
Investments:	
Term deposits/GICs	
Stocks, bonds	
RSPs	
Pension holdings	
Other:	
Total Assets	$

Liabilities (what you owe)

	Total
Mortgage (balance outstanding)	$
Income/property taxes	
Car loan (balance outstanding)	
Credit cards	
Personal line of credit	
Other loans	
Other debts	
Unpaid bills	
Other obligations:	
Total Liabilities	$

Net Worth

Assets	
Minus (–) liabilities	-
Net Worth	$

Two simple and often-used calculations that help estimate how much of your income can be allocated to monthly housing costs are the Gross Debt Service Ratio (GDS) and the Total Debt Service Ratio (TDS).

The GDS Ratio - Most lenders recommend that you spend no more than 32 per cent of your gross (before tax) monthly income on combined housing costs – monthly mortgage principal and interest, taxes, utility costs, and if applicable 50 per cent of condominium fees. For instance, if your gross monthly income is $4,000, you shouldn't pay more than $1,280 ($4,000 x 32 per cent) in monthly housing expenses. Follow these three easy steps to estimate the mortgage you can afford.

USING THE GDS RATIO

Complete Step 1 to figure out your GDS Ratio.

Step 1: Gross Monthly Income* × 32% (Maximum Gross Debt Service Ratio) = A (Maximum Affordable Monthly Household Costs)

*Before personal income taxes and deductions

Complete Steps 2 and 3 to give you a rough estimate of the maximum mortgage you can afford at different interest rates and amortization periods.

Step 2: A − monthly property taxes, heating costs and 50% of condominium maintenance fees if applicable = B (The Maximum Mortgage Payment You Can Afford Each Month)

Step 3: B ÷ Mortgage Payment Factor** × 1,000 = C (Total Mortgage You Can Afford)

**(See Mortgage Payment Table on page 10.)

MORTGAGE PAYMENT TABLE

The following table shows the monthly payment factor of principal and interest for each $1,000 of mortgage. The payment will vary at different interest rates and for different amortization periods. For example, the monthly principal and interest payment for a $100,000 mortgage @ 6.0% per annum with a 25-year amortization is ($100,000 ÷ 1,000) x 6.398 = $639.80

Rate	25 years	20 years	15 years	10 years
4.00%	5.260	6.043	7.380	10.109
4.50%	5.535	6.304	7.628	10.344
5.00%	5.816	6.571	7.881	10.582
6.00%	6.398	7.122	8.399	11.065
6.50%	6.698	7.405	8.664	11.311
7.00%	7.004	7.693	8.932	11.559
7.50%	7.316	7.986	9.205	11.810
8.00%	7.632	8.284	9.482	12.064
8.50%	7.954	8.586	9.762	12.320
9.00%	8.280	8.892	10.045	12.579
10.00%	8.945	9.517	10.623	13.103
11.00%	9.625	10.156	11.213	13.637

*Interest calculated half-yearly, not in advance.

The TDS Ratio - Another way of looking at what you can afford is by calculating your Total Debt Service Ratio (TDS). What should your total debt load be? According to most lenders, you should use no more than 40 per cent of your gross monthly income to service your mortgage and cover other debts and obligations (such as credit card bills, car payments, personal loans, alimony, and other monthly expenses). If your TDS Ratio exceeds 40 per cent, consider reducing your outstanding debts before you try to take on a mortgage.

USING THE TDS RATIO

Gross Monthly Income × 40% (Maximum Total Debt Service Ratio) = ________ (Maximum Monthly Debt Load You Can Afford)

Keep in mind that the GDS and the TDS are prescribed maximums. The lower your debts are below these maximums, the more affordable your home and lifestyle will be.

Your Down Payment

Figuring out how much you can afford to spend each month is only half of the equation. You may want to make a down payment – the money you put toward the price of a home. A down payment generally ranges from 5 per cent to 25 per cent of the purchase price. Some financial institutions offer no-down payment mortgages. If you have a good credit history, but haven't been able to save the down payment, this option may be for you. Keep in mind that the higher your down payment, the lower the interest costs over the life of the mortgage.

Coming up with a down payment may be your biggest challenge. If you make a down payment of 25 per cent of the appraised value or purchase price of the property, you can get an **uninsured low-ratio or conventional mortgage**. On a $200,000 home your down payment would be $50,000.

If you can't come up with the 25 per cent required for an uninsured low-ratio or conventional mortgage, you can get a **high-ratio mortgage** – which is usually for more than 75 per cent of the appraised value or purchase price.

A high-ratio mortgage must be insured against default, or non-repayment, by the federal government through the Canada Mortgage and Housing Corporation (CMHC) or an approved private insurer (the lender usually arranges this). The borrower pays a one-time insurance premium to the insurer (the rate varies depending on the amount of the down payment – check with your lender) and additional charges may apply. The default insurance premium is usually added to the principal amount of the mortgage. With mortgage default insurance, if you default on your mortgage, the lender is paid back by the insurer.

FACT:

do you need a mortgage that is more than 75% of the purchase price of your home? If so, you must buy mortgage default insurance.

Unless you have an inheritance, win the lottery or have generous relatives, getting your down payment together will mean a lot of saving, planning and budgeting. But it will be worth it. The more you put down, the more you'll save in the long run (a smaller mortgage means less interest to pay). If you don't have quite enough to make a down payment, try to get on a savings schedule where you set aside a percentage of your gross income each year.

The RRSP Home Buyer's Plan

Are you a first-time homebuyer? If so, take a look at the federal government's "RRSP Home Buyer's Plan." It allows first-time home buyers to withdraw up to $20,000 per person from their Registered Retirement Savings Plan (without tax liability) to buy a home in Canada.

Among the conditions of the Plan:

- you have to enter into a written agreement to buy or build a qualifying home;
- the home must be your principal place of residence and includes all types of homes (e.g., single-family homes, semi-detached homes, townhouses, condominium units, or mobile homes);
- your RRSP contribution must be in your RRSP for at least 90 days before you make a Home Buyer's Plan withdrawal;
- you must withdraw funds within the same calendar year in one or more installments. For instance, if you withdraw funds over two years, you will be taxed on the funds withdrawn in the second year. In addition, you will lose contribution room in your RRSP. For more information, contact the Canada Revenue Agency or check the Web site at www.cra-arc.gc.ca;
- of the borrowed funds, a minimum of 1/15th must be repaid each year until the full amount is repaid to your RRSP. Basically, you're borrowing a tax-free, interest-free loan from yourself. However, bear in mind that you are not earning interest on the RRSP funds used for your down payment. Your RRSP repayment period begins in the second year after your initial funds withdrawal.

Before you cash in your RRSP to buy a home, weigh the pros and cons carefully. Is it worth it to give up the advantages of long-term compounding interest on your RRSPs to buy a home? Can you afford the RRSP payback requirement? If you can get a low mortgage rate and your investments are paying a relatively low rate of return, financing your home with RRSPs may be a wise move. Talk to a financial advisor. Find out more about this program from the Canada Revenue Agency (1-800-959-8281, www.cra-arc.gc.ca).

Don't Forget the Extra Costs

Keep in mind there's more to buying a home than the down payment and mortgage. You'll need to budget another 1.5 per cent to 4 per cent of the price of your home for extras associated with the original purchase such as:

Survey fee: Lenders will want proof that the property complies with all relevant by-laws and that additions fall within the property's boundaries. A survey of the property can cost around $500 and may be required. See if the seller has a recent survey; the lender might accept it and you could save yourself some money. If you are obtaining title insurance, it may be an acceptable alternative to a survey – title insurance is an insurance policy you can purchase to protect your investment in your property if there is a problem with title (see definition page 40).

Inspection cost: With resale homes, make sure you're making a wise investment with a thorough home inspection to check plumbing, electrical work and any structural flaws. It will cost anywhere from $150 to $500.

Mortgage Default Insurance: If you have a down payment of less than 25 per cent, you'll have to pay for this.

Fire Insurance: You can't obtain a mortgage without a fire and damage policy that will cover the replacement cost of the property. Costs will vary by property and insurance company.

Provincial fees: Most provinces charge a fee ($100 or more) for registering a mortgage. These registration fees are usually added to your legal bill.

Land Transfer Tax: Depending on the province you live in, you may have to pay a land transfer tax. The cost, which varies by province, is based on a percentage of the total cost of the property.

Legal fees: To protect your interests, it's a good idea to use a lawyer or notary to handle the purchase of your home. Legal fees vary widely.

Goods and Services Tax: If you buy a newly constructed house, you'll have to pay GST.

Moving expenses, new appliances and service hook-up fees: Costs vary widely for these. Shop around and budget for them.

Closing or adjustment costs: These are expenses for any necessary adjustments to be made between you and the seller, like property taxes and utility bills.

TIP:

Don't forget ongoing maintenance and other costs must be factored into your budget after you move into the house.

The Home Buying Search and Purchase

Finding the Right Home

Now that you know how much you can afford and the costs involved, you're ready to start looking for your new home. The first thing you should do is to apply for a **pre-approved mortgage**. That way, when you find your dream home, you'll already have your financing in place.

A pre-approved mortgage is a preliminary approval by a lender of your application for a mortgage to a certain maximum amount and rate. Armed with a pre-approved mortgage, you can negotiate your house purchase with confidence. You'll know exactly how much you can afford to spend, what your mortgage payments will be and at what interest rate. Plus a pre-approved mortgage helps to demonstrate to prospective vendors that you are a serious buyer.

If you qualify, the interest rate will be fixed for 60 to 90 days, depending on your financial institution. This means if rates go up during that period, you retain your fixed rate. But if rates go down, you automatically get the lower rate. When the time comes to make an offer, simply contact your lender.

The next step is to start looking at properties, either on your own or with the help of a real estate agent. The advantage of using an agent is that he or she has immediate access to a wide range of available properties. Your agent will also be able to provide information on current selling prices for comparable properties, arrange appointments for you to view homes, negotiate with the vendor and handle the paperwork involved in making an Offer to Purchase. Talk to family and friends to get a referral.

Whether you use an agent or look on your own for a home, you should be clear about your needs. Is location critical? How close do you want to be to services such as transit, schools, shopping, hospitals and community centres? Urban, suburban or rural? Do you want a new home or perhaps one that is under construction? Or do you have your eye on a charming older home?

Make a list of what you must have and what you would like, but be willing to compromise. The work sheets on the following pages will help you compare the features of different homes. Photocopy it and take copies with you while you're house hunting.

HOME COMPARISON CHECKLIST

Home hunting may last several months. Here's a checklist to help you comparison shop and compile a list of places that interest you.

Address ____

Agent _____________________ Telephone _____________

Asking price ___________ Occupancy date _____________

TYPE OF HOME ❍ New ❍ Resale ... If resale, age of home _______

STYLE OF HOME

❍ Detached ❍ Townhouse ❍ Semi-detached ❍ Duplex
❍ High-rise ❍ Low-rise ❍ Loft ❍ Mobile home

OWNERSHIP ❍ Freehold ❍ Condominium ❍ Leasehold

EXTERIOR

❍ Brick ❍ Wood ❍ Aluminum siding
❍ Vinyl siding ❍ Brick and siding ❍ Stucco
❍ Condition of Roof ____
❍ Other ____

INTERIOR

Floor Area ____

Number of rooms _______________ Number of bathrooms ______________

Number of bedrooms ____________ ❍ Master bedroom en suite

Ground floor bathroom	Yes	No	Eat-in kitchen	Yes	No
Appliances	Yes	No	Window coverings	Yes	No
Hardwood floors	Yes	No	Carpeting	Yes	No
Separate dining room	Yes	No	Separate family room	Yes	No
Fireplace	Yes	No	Woodstove	Yes	No
Spare room for den or home office				Yes	No
Basement for storage or workshop				Yes	No

Other features ____

DOORS AND WINDOWS

Type/condition____

INSULATION ____

SEWER SYSTEM

❍ Municipal ❍ Septic

WATER

❍ Municipal ❍ Well

ELECTRICAL SYSTEM

❍ 100 amp ❍ Fuses
❍ 200 amp ❍ Circuit breakers

❍ Other ______________________________________

TYPE OF HEATING SYSTEM

❍ Oil ❍ Gas ❍ Electric

LOT

Size of front yard: _______________ Size of backyard: ______________________

Is there a garden?	Yes	No
Is there a deck/verandah/patio?	Yes	No
• Is there room to add one?	Yes	No
• Will zoning regulations or the condominium bylaw allow you to do so?	Yes	No

GARAGE/PARKING

❍ Attached ❍ Detached ❍ Carport
❍ Private driveway ❍ Mutual driveway ❍ Street parking

LEGAL REQUIREMENTS

❍ Assessments ❍ Easements/servitudes ❍ Zoning ❍ Up-to-date survey

ADDITIONAL FEATURES

❍ Heat recovery ventilator
❍ Central air conditioning
❍ Apartment for rental income
Other ___________________________________
❍ Security features
❍ Barrier-free
❍ Pool

ONGOING COSTS

Property taxes ________________________________
Other taxes/assessments _______________________
Heating ______________________________________
Electricity ____________________________________
Other ____
Condominium fees _______________
Home insurance _________________
Garbage pick-up ________________
Water ___________________________

LOCATION OF HOME

❍ Sub-division ❍ Suburb ❍ Urban centre ❍ Rural community

DISTANCE TO

Work ____
Public transportation __________________________
Shopping _____________________________________
Recreation facilities ___________________________
Places of worship ______________________________
Fire station ___________________________________
Spouse's work ___________________
Schools _________________________
Parks/playgrounds ________________
Restaurants ______________________
Police station ____________________
Hospital _________________________

ENVIRONMENT/NEIGHBOURHOOD

❍ Noise ❍ Traffic ❍ Safety
❍ Environmental hazards ❍ Future development plans

❍ Other ____

CONCERNS/PROBLEMS WITH HOME

❍ Visible cracks ❍ Signs of water leakage ❍ Structural

❍ Other ____

OVERALL

Things I like about the home: ____

Things I dislike about the home: ____

Arranging an Offer

You've found the house you want. What's next? Before you sign your name to anything, remember two fundamental rules:

1. Check with your lawyer (or notary in Quebec) to ensure your legal interests are being protected.
2. Give yourself time to think if this is really the home for you.

Before the Offer to Purchase

- Visit the home at least twice, once during the day and once at night. Perhaps talk to some of the neighbours.
- Make sure you know what you are buying. Look carefully at the list of specifications provided by the real estate agent or the vendor.

Preparing the Offer to Purchase

- Decide on a figure and prepare the Offer to Purchase (or Agreement of Purchase and Sale). This offer or agreement is a legal document and should be taken seriously. It will include all basic details associated with the sale – names, address, the purchase price, amount of deposit, the closing date, etc. Usually, the real estate agent will help you fill in the form or complete it for you. If you are looking on your own, or as an assurance, ask your lawyer or notary to help you.
- Make sure that everything you want included is listed in the Offer to Purchase. For example, if appliances are included, make sure you list them individually (include serial numbers) and state that they must be in good working order. Also, if you want to make your offer conditional on getting financing or a satisfactory building inspection, put it in writing.
- Your offer to purchase will either be firm or conditional. A firm offer means that you will buy the property as outlined in the Offer to Purchase and that there are no conditions attached. Once the vendor accepts your offer, you are both bound to the agreement. A conditional offer means that you will buy the property if certain conditions are met.

The conditions in the offer have to be significant and have to be listed. Substantial conditions include: securing financing, selling a property or a satisfactory building inspection. If these conditions aren't met, the offer becomes null and void. If the building inspection finds only a couple of dripping taps, for example, that won't be enough to withdraw the Offer to Purchase.

Submitting the Offer to Purchase

- After you have signed the Offer to Purchase, it is returned to the vendor (usually through the real estate agent or your lawyer). There will be a time limit involved (usually up to three business days). The offer will then come back to you as accepted or as changed.
- You will be expected to pay a deposit to confirm your offer to purchase.
- If the vendor changes the offer (called a counteroffer), you have a certain amount of time to decide whether to agree to the changes, revise them or withdraw your offer.
- After the Offer to Purchase is accepted, you may be required to pay a further deposit within a certain period of time which will be applied to the down payment.
- If you are buying the property with someone who is not your legal spouse, have your lawyer prepare a partnership agreement at this time. The agreement should specify which property is being purchased, how much each partner is contributing to the purchase, and a fair way to dissolve the partnership. This agreement will protect both your partner's legal and financial interests and yours. Generally, when you are purchasing with your spouse, you will be listed as joint tenants. If you are purchasing with a friend, you are listed as tenants in common, unless otherwise specified. With joint tenancy, if one person dies, the property automatically goes to the other person. With a tenant in common relationship, the deceased person's portion goes to their estate.

Closing the Deal and Taking Possession

After the mortgage has been approved (mortgages are discussed in the next section) and before the deal is closed, you must deliver certain documents and monies to your lawyer and the lender's lawyer. These include:

- A copy of the accepted Offer to Purchase and any conditional waivers that have been added.
- Proof of fire insurance (usually in the form of a copy of your homeowner's insurance policy).
- A survey signed by a qualified land surveyor. In the case of an existing home, the survey on file may be acceptable. Or you may want to explore title insurance, which may not require a survey.
- The money necessary to cover the balance of your down payment, legal fees, applicable taxes, land registration fee, survey fee (if applicable), and adjustments (such as fuel oil, utilities, prepaid property tax, etc.).
- If you are purchasing a condominium, you may be required to make a contribution to the reserve fund at the time of closing. You may also be required to pay a portion of the common expenses paid in advance by the vendor covering the days that you will be the owner.

Before the deal is closed and you take possession, you should arrange for utility companies (such as electricity, water, fuel and telephone) to begin service in your name.

Your first regular mortgage payment is likely to be due one regular payment period after the Interest Adjustment Date (IAD). This is the date on which the term of your mortgage really begins. If mortgage funds have been advanced before the IAD, you will be required to pay interest from the date the funds are advanced until the IAD.

Example: Suppose your lender closes the deal on January 20. Your interest adjustment date is February 1 and your first scheduled bi-weekly mortgage payment is February 15. You pay interest on the money for the 11 days between the time the seller receives the money (January 20) and the IAD (February 1). How you pay this interest is between you and your lender, so make sure you ask.

Tip:

Don't forget your address change. Notify the post office, phone company, financial institution(s), doctor, dentist, your children's school, and all other interested parties. Visit the post office for the forms.

Getting your Mortgage

Understanding the Key Terms

The down payment pays only a portion of the home's purchase price. The outstanding balance is financed in the form of a mortgage from a financial institution or private lender. A mortgage is simply a personal loan used to purchase a property. You pledge the property being purchased as security for the loan.

The amount of the loan is called the *principal*. *Interest* is added to the amount you have borrowed to compensate the lender for the use of their money. Your mortgage is repaid in regular payments (e.g., monthly, bi-weekly, weekly, semi-monthly), which are applied toward the principal and interest (this is why it is also referred to as a blended payment).

Term is the number of months or years the mortgage contract covers, typically six months to five years, during which a mortgagor pays a specified interest rate.

Amortization refers to the actual number of years it will take to repay the mortgage in full. This is usually longer than the term of the mortgage. For instance, you may have a five-year term amortized over 25 years. Although most mortgages are amortized over 25 years, you can choose a shorter period if the payments meet your budget. A shorter amortization period will save you money in interest payments over the life of the mortgage.

Equity is the difference between the amount for which you can sell your property and the amount you still owe on the mortgage. The equity in your home can strengthen your position when negotiating further borrowing.

Shopping For A Mortgage

When shopping for a mortgage, keep your goals and needs in mind. There are many options, and a mortgage can be customized for your own circumstances. Make sure you understand the mortgage contract, which takes time to read and understand. Canadian banks have recently taken steps to make this easier for you by redesigning their mortgage contracts so they use plain language.

As already discussed (page 11), types of mortgages include *uninsured low ratio* or *conventional mortgages* and *high ratio mortgages*. Then there are a variety of features and payment options to consider. Mortgages are available on a closed or open basis, at fixed or variable rates and can have various terms generally ranging from six months to five years, but some institutions will offer seven or 10-year terms. Generally, most mortgages are amortized over 25 years.

- *Open vs. Closed*

With an *open* mortgage, you can pay off as much of your debt as you wish, whenever you want, without being charged a pre-payment fee. This could allow you to pay off your mortgage more quickly (assuming you have the cash flow to do so), potentially saving you thousands of dollars in interest over the life of the mortgage. An open mortgage can be a good option if you want flexibility. For example, if you are considering selling, or you are expecting to receive an inheritance settlement. You can expect to pay a higher interest rate for this flexibility.

With a *closed* mortgage, you get a more favourable interest rate for agreeing to keep the mortgage for the full term. It is for a set term and has fixed conditions. In some cases, the agreement allows pre-payment, although a fee may be charged. While most closed mortgages in Canada do offer a range of no-fee, partial pre-payment privileges, options differ between lenders. If your income is static, and you want the security of guaranteeing your monthly payments over a fixed period, a closed mortgage may be right for you.

All mortgages are fully open at the end of their term. This allows you to repay all or part of the outstanding principal without incurring any pre-payment fee on the maturity date.

- *Fixed Rate vs. Variable Rate*

A *fixed rate* mortgage carries a set interest rate for a specific period of time (the term of the mortgage) that does not fluctuate with rate changes. The regular payment of the principal and interest remains the same throughout the term. The benefit of choosing this option is that you are protected if interest rates rise. However, you could be locked into paying a higher rate if they fall. In a situation where interest rates are rising or you want the security of guaranteeing your monthly payments over a fixed period, it may be to your advantage to have a fixed rate mortgage.

With a *variable rate* (or floating rate) mortgage, the interest rate rises and falls from time to time as market conditions change. Generally the payments remain constant throughout the term, although your lender may offer other options. When payment amounts are constant, should interest rates go down, more of your mortgage payment goes to your principal; and if interest rates go up, less goes toward your principal. But if interest rates rise dramatically as they did in the early '80s, your regular payment may not cover all of the interest owing. In this case, the unpaid interest will be added to the principal still owing and this can erode your equity. Some mortgage agreements may allow the lender to increase your payments to compensate for the rise in interest rates.

Some variable rate mortgages are completely open and you can pay off all or part of the mortgage at any time without a pre-payment fee. Others may be closed and charge a pre-payment fee for paying off all or part of the mortgage early.

• *Short-term vs. Long-term*

You can choose the term of your mortgage. Typically, terms range from six months to five years, but it's possible to arrange six, seven, 10 and even 25 year mortgages depending on the lender.

A *short-term* mortgage is typically for two years or less, whereas a *long-term* mortgage is for three years or more. Generally speaking, the longer the term, the higher the interest rate. The benefit of a long-term mortgage is the security of knowing exactly what your interest rate and payments will be for an extended period.

In contrast, the shorter the term, the lower the interest rate you generally pay. A shorter term is also helpful if you plan on selling your home and will no longer need a mortgage.

Specialty mortgages are also available through some lenders. For instance, you may be able to split your mortgage into a combination of terms or types or even include other lending products such as a line of credit. While some mortgages allow you to add other features, these need to be negotiated when you arrange your mortgage.

Other features and options

- *Partial pre-payment:* This allows you to make extra payments against your principal (see page 31-32).
- *Compound interest:* This refers to the interest that's charged on the interest owing on your mortgage. The more frequent the compounding, the more interest you'll pay. Most traditional mortgages have the interest compounded semi-annually. In the case of variable rate mortgages, interest is usually compounded monthly.
- *Increases in regular payments*: Some lenders will let you increase your regular payments. These vary by lender but are generally between 10 per cent and 25 per cent. This can save you thousands of dollars in interest costs over the life of your mortgage.

Tip:

When shopping for a mortgage, research and compare your options. Check with several lenders and decide on one that best meets your needs.

- *Frequency of payments:* With this option, you are not confined to making your mortgage payments monthly. You can coincide your payments with your pay cheques, making them weekly, for example. This flexibility may help you budget better, and the more frequently you pay your mortgage, the more you'll save on interest costs over time.

- *Portability:* If you are selling your present home and buying another, this option allows you to take your mortgage – with the same term, rate and balance – and apply it to your new house. If your mortgage isn't portable, don't sign for a longer term than you're likely to stay in the house or you could wind up paying a pre-payment fee to break the mortgage agreement.

- *Assumability:* This feature allows the buyer of your house to take over or "assume" your mortgage. If your mortgage has a fixed interest rate lower than current rates, it could be an attractive selling feature. Your lender may or may not release you from your mortgage. If you are released and the buyer defaults, you won't be responsible for the payment. As provincial laws vary, check with your solicitor or notary.

- *Early Renewal:* This allows you to renew your mortgage before it matures. It is a useful option if you expect mortgage rates to increase because it allows you to take advantage of current rates. If current interest rates are lower than your existing mortgage rate, you will likely have to pay a pre-payment fee for renewing early. Your lender can calculate this for you.

Different lenders may offer other features and options such as a convertible mortgage, blending and extending interest rates and interest rate buydown. Make sure to inquire about options that interest you.

Other Types of Mortgages

- ***Second Mortgage***

A second mortgage is granted when there is already one other mortgage registered against your property. If you default and the property is sold, the second mortgage is paid only after the first mortgage has been repaid. Not all lenders offer second mortgages because it's riskier for the lender, and if they do, a higher interest rate is usually charged.

- ***Leasehold Mortgage***

The leasehold mortgage is a mortgage on a home where the land is leased rather than owned. These mortgages must be amortized over a period that is shorter than the length of the land lease.

- ***Collateral Mortgage***

This is a mortgage which secures a loan by way of a promissory note, where a pledge of a durable good such as a car or boat is made as security for the loan. You can also arrange a secured line of credit that allows you to use the equity in your home to access credit at relatively low variable interest rates.

- ***Bridge Financing***

This refers to a special short-term loan needed to cover the time between completing the purchase of a property and finalizing the arrangements to pay. This usually occurs when two properties are involved and the closing dates don't match. For a short time, you may find yourself the owner of both properties.

Where can I get a mortgage?

Those in the business of lending money for mortgages include:

- *Banks*
- *Trust companies*
- *Caisses populaires*
- *Finance companies*
- *Private lenders*
- *Credit unions*
- *Insurance companies*
- *Mortgage brokers*

Your Mortgage Checklist

When comparison shopping, think about what features are most important to you and make a note of what each lender is offering. Here are some things to consider:

- ✔ The types of mortgage available for the amount you need.
- ✔ The interest rate and the length of time for which the rate applies.
- ✔ What the regular payment covers. Is it principal and interest only? Does it cover other costs, such as property tax or insurance premiums required by the government?
- ✔ Pre-payment, repayment, renegotiation and renewal options, in addition to any charges associated with them.
- ✔ How and where your mortgage is serviced? For example, will it be through telephone banking, Internet banking or in-branch?
- ✔ Any restrictions on the home or property? Is the approval of the lender required for changes to property use while you own the property or when you're selling it?
- ✔ Fees, if any, required by the lender in order to set-up, discharge or renew the mortgage.
- ✔ Other features, conditions and options.
- ✔ The general reputation of the lender.

- *Vendor-Take-Back Mortgage*

If it's a slow market, or the vendor wants the benefit of a steady return on the mortgage, he/she may agree to a vendor-take-back (VTB) mortgage. In this situation, the vendor will offer to help a potential buyer by lending a portion of the purchase. The vendor's loan usually comes with favourable or flexible terms. It may be an open loan or have a lower interest rate than that offered by financial institutions. Take your time before you rush into an agreement. Chances are, if it seems too good to be true, it probably is. Make sure a lawyer checks your agreement before you sign.

Mortgage Insurance

Sometimes part of the regular mortgage payment is used to pay mortgage insurance costs.

There are several types of insurance, some compulsory and some optional.

- *Mortgage default insurance:* If you are borrowing more than 75 per cent of the value of the property, your mortgage must be insured against default by CMHC or a private insurer, such as GE Capital Mortgage Insurance. In order for your mortgage to be default insured, the insurer may require payment of an application/appraisal fee to process and confirm approval of the mortgage.

  With mortgage default insurance, if the mortgage is in default and the lender cannot collect from the borrower, the insurers pay the lender back.

- *Mortgage life insurance:* This optional coverage can be obtained when you take out your mortgage. If you die before the mortgage is paid off, the insurance will cover the balance, usually up to a prescribed maximum.

- *Mortgage critical illness insurance:* Also available at some financial institutions, it is an enhancement to your mortgage life insurance. It insures you to assist with paying off your mortgage if you are diagnosed with either cancer, a heart attack or a stroke.

- *Mortgage payment insurance:* Offered by some financial institutions, it insures that your regular mortgage payments are covered in the event that your income is suddenly reduced (for example, if you are laid off or unemployed for a period of time).

- *Mortgage disability insurance:* Available at some financial institutions, it protects you if you cannot make your mortgage payments due to an accident or illness that leaves you unable to continue your usual employment.

Of course, borrowers must get fire insurance as a condition of getting a mortgage; however, you arrange and pay for this separately.

Tip:
With your approval, the lender will check your credit history with a consumer reporting agency. You should check your information in advance to ensure there is no erroneous information in your file. View your credit information by contacting Equifax Canada at 1-800-465-7166 (www.equifax.ca), TransUnion Canada at 1-866-525-0262 (www.tuc.ca), or Northern Credit Bureaus at 1-800-532-8784 (www.creditbureau.ca).

Applying for a Mortgage

Once you've decided on the lender that best meets your needs, the next step is arranging your mortgage. You can apply for a mortgage in person, by phone or even online via the Internet. Here are some tips to help you get ready:

- Get comfortable with mortgage terms such as amortization, term, fixed, open and closed.
- Be prepared to share personal information with your lender, particularly related to your finances – your net worth (assets and liabilities), monthly expenses and employment earnings.
- Before applying, find out what documentation you'll need. You'll likely need copies of the following: property or house plans (if the house is being built); certificate of location; survey certificate if applicable; the accepted offer; and your pre-approved mortgage certificate, if one was issued.
- Don't be afraid to ask questions.

When the lender assesses your application, he/she will look at your credit history, your capacity to make your mortgage payments and whether the property you want to buy offers good enough security for the loan. The lender may need a few days to process your formal mortgage application.

Paying Your Mortgage

How to Pay Off Your Mortgage Quickly

Most home mortgages are repaid in the form of blended, equal, regular installments. Blended means that the payment is applied toward both the principal and interest. Sometimes, part of the payment covers annual property taxes.

There are ways you can minimize your mortgage interest costs and pay off your mortgage quickly.

An important consideration in paying down your mortgage is the **pre-payment** privilege included in your agreement. Many institutions allow you to make extra lump sum payments against the mortgage principal, which help you to pay down your mortgage faster. The lump sum amount varies by lender and type of mortgage. Fifteen per cent of the original principal is common, but it can be up to 25 per cent of the original mortgage amount. This is in addition to your regular mortgage payments.

Usually, you can do this on the anniversary date of your mortgage (but your lender could allow you to make this payment any time); you may be able to divide the amount and pay it in installments over the course of a year, or on regular scheduled payment dates you may be able to double up your monthly payments without incurring a pre-payment fee.

Find out when you can do this and how much you can pay. If you miss the pre-payment due date, you may have to wait until your mortgage's next anniversary. Take advantage of all pre-payment privileges allowed by your lender to pay your mortgage quicker than set out in your agreement.

When negotiating or renewing your mortgage, consider these strategies to help pay off your mortgage quickly and save money:

- Make your payments as frequently as possible. The most common payment frequency is monthly, but most lenders offer other options, such as semi-monthly, accelerated bi-weekly and accelerated weekly payments. The extra payments not only chip away at your principal, but decrease the amount of interest you pay.

  For example, you may "accelerate" your payments and save thousands of dollars in interest. With an accelerated payment schedule, over a year you'll end up paying the equivalent of an extra month's payment. Take your monthly payment and divide it by two (accelerated bi-weekly) and multiply by 26 to get your new annual payment. Or divide your monthly payment by four (accelerated weekly), then multiply by 52. Say your monthly mortgage payment is $800 ($9,600 annually). By making accelerated bi-weekly payments, you'll pay $400 every two weeks and $10,400 annually. If you only take your annual payments and divide them by 26 or 52, by the end of the year you will have paid off less of your mortgage, compared to the "accelerated" payment schedule.

Accelerated Bi-weekly vs. Monthly Payments

$100,000 mortgage at 6.0% interest compounded semi-annually.

Payment Frequency	Number of Payments	Interest	Principal
Monthly @ $640/month	300 (25 years)	$91,941	$100,000
Accelerated Bi-weekly @ $320/2 weeks	546 (21 years)	$74,335	$100,000
Amount saved:		$17,606	

- Pay as much as you can for your regular payment. You can usually increase your payment by at least 15 per cent (depending on the lender) and by doing so, you will reduce the length of the amortization period and pay less interest.
- Choose the shortest possible amortization period. Try to reduce it every time you renew your mortgage.

The Effect of Shorter Amortization

$100,000 mortgage at 7% interest

Amortization Period In Years	25	20	15	10
Monthly Payment of Principal and Interest*	$700.42	$769.31	$893.25	$1,155.94
Total of Mortgage Payments Over Amortization Period	$210,123	$184,634	$160,785	$138,713

*Derived from the Mortgage Payment Table on Page 10.

Changing the Terms and Conditions

All mortgages are fully open at the end of their term at which time you can renew the mortgage, refinance or pay the loan in full. If you aren't ready to pay off your mortgage, renewal time is an opportunity to re-negotiate interest, terms and conditions so you can pay your mortgage off faster. If your circumstances change significantly during the term of your mortgage, you may want to discuss with your lender what options are available to you.

- *Renewal*

Your lender will send you a letter a few weeks before the end of your mortgage term with an offer to renew your mortgage and give you options to select. The renewal offer sets out the various terms (e.g., six months, one year, two years) and usually gives the amount that you would pay (e.g., monthly, bi-weekly, whichever you were already paying) for each term. It usually states the amortization for the number of years remaining. You can choose any of the terms and may also have the option to: pay more frequently, change the amortization (which would increase the payment amount) and reduce the principal. These may not be set out in the renewal offer; you may have to ask about them. To renew your mortgage, you may be charged a fee.

You may also have the option of early renewal. Although early renewal may be a feature in your mortgage agreement, you may have to pay a pre-payment fee to compensate the lender for lost interest.

- *Refinancing*

Refinancing means to pay in full the existing mortgage and/or other liens/debts against the property and to arrange for a completely new mortgage with the same lender or a different lender. When you refinance you must pay for the associated application, appraisal and legal costs again, because you are taking out a new loan.

If you refinance at the end of your term, you won't have to pay a pre-payment fee. But if you refinance mid-term, you are breaking the contract and will have to pay a pre-payment fee.

• *Discharging the Mortgage*

Discharging means taking the lien or lender's legal claim off your property after the mortgage is paid in full. This may occur as planned at the end of the amortization period. You may also choose to do so at the end of any term without pre-payment fees or during a term with pre-payment charges. Lenders usually charge a fee for the preparation of and/or signature of the discharge document. While it's possible to do yourself, most home buyers have a lawyer handle the discharge.

If You Need Help

If you fall on hard times or are faced with a crisis (e.g., loss of a job or critical illness), you may need help repaying your mortgage.

As difficult as it is, it's best to confront a financial dilemma head on. At the first sign of trouble, immediately make an appointment with your lender to explain the situation. He or she may be better able to assist you during your temporary difficulties if you deal with the situation early. Your lender may be able to work out a number of options including decreasing your payments, increasing your amortization period and consolidating other loans.

For instance, some lenders allow you the option of skipping a mortgage payment once a year, or even up to four consecutive payments under some conditions.

Sometimes you can apply any pre-payments you've made during your mortgage term to current mortgage payments which are due. Make sure these options are in your contract up front.

There are a number of insurance options offered by lenders and private insurers including mortgage, disability and critical illness. If it will give you peace of mind to have a policy, shop around for the one that suits you the best.

If you default – or don't make a mortgage payment – your lender will not immediately step in and take possession of your home. However, if you routinely miss payments and don't explain your circumstance to your lender, you could lose your home.

A Final Word

Buying a house is a complicated process but as long as you do your homework, it can also be very satisfying. Take time to shop around and find the realtor, lender, neighbourhood, home and mortgage that best fit your needs. Ask questions and make sure you're comfortable with the answers. All of your efforts will be well rewarded on the exciting day when the deal closes and you move into your new home.

Sources of Information

You can find information on mortgages and buying a home from a variety of sources, including:

- Financial institutions and private lenders.
- A lawyer or community legal clinic.
- Canada Mortgage and Housing Corporation (1-800-668-2642, 613-748-2000, www.cmhc-schl.gc.ca): Crown corporation that offers products, services and information on every aspect of owning a home. CMHC has an excellent consumer guide called *Homebuying Step by Step*, as well as an online Mortgage Calculator.
- Canadian Home Builders' Association (613-230-3060, www.chba.ca): National organization representing the professional home building industry. There are also many provincial and local home builders' associations – check your telephone directory or the CHBA Web site.
- Canadian Real Estate Association (613-237-7111, www.mls.ca): National trade association representing real estate agents/brokers and salespeople. Affiliated members include real estate boards and associations across the country.
- Insurance Bureau of Canada (1-800-387-2880, 416-362-2031, www.ibc.ca): Represents companies that insure the homes, cars and businesses of Canadians. Offers information on insuring your home.
- Your daily newspaper and personal finance magazines.
- Your local bookstore and library.
- The Internet. Find information, the most up-to-date mortgage rates from financial institutions, and even interactive mortgage calculators on a number of Web sites. Check out the following:
    - BMO Bank of Montreal: www.bmo.com
    - Scotiabank: www.scotiabank.com
    - CIBC: www.cibc.com
    - Canadian Western Bank: www.cwbank.com
    - HSBC Bank Canada: www.hsbc.ca
    - Laurentian Bank of Canada: www.laurentianbank.com
    - National Bank of Canada: www.nbc.ca
    - RBC Royal Bank: www.rbcroyalbank.com
    - TD Canada Trust: www.tdcanadatrust.com
    - Canada Mortgage: www.canadamortgage.com
    - Cannex Financial Exchanges Ltd: www.cannex.com/canada/english
    - Mortgages Canada: www.mortgagecentre.com
    - Canoe Money: http://money.canoe.ca

Glossary of Terms

Amortization period: The actual number of years it will take to repay a mortgage in full.

Appraised value: An assessment of the market value of a property by a certified appraiser.

Blended payment: A mortgage payment consisting of both a principal and an interest component, paid regularly during the term of the mortgage. The principal portion increases each month, while the interest portion decreases, but the total monthly payment doesn't change.

Canada Mortgage and Housing Corporation (CMHC): Crown corporation that administers the National Housing Act for the federal government and creates and sells mortgage loan insurance products.

Closed mortgage: A mortgage agreement that cannot be prepaid, renegotiated or refinanced before maturity, except with compensation or breakage costs.

Closing date: The date on which the sale of property becomes final and the new owner takes possession.

Collateral mortgage: A loan backed by a promissory note and the security of a mortgage on a property. The money borrowed may be used for any reasonable purpose, such as home renovations or a vacation.

Conditional offer: An offer to buy a property if certain conditions are met, e.g. home inspection.

Conventional mortgage: A mortgage that does not exceed 75 per cent of the appraised value or purchase price of the property, whichever is less. Mortgage loan insurance is not required for this type of mortgage.

Critical illness insurance: Is an enhancement to mortgage life insurance offered by some lenders. It provides coverage to assist with paying off a mortgage in the event of critical illness (cancer, heart attack and stroke).

Effective interest rate: The real rate of interest after the effects of compounding are included. More frequent compounding adds up to a higher effective rate.

Firm offer: An offer to buy the property as outlined in the Offer to Purchase and with no conditions attached.

Fixed rate mortgage: A mortgage for which the rate of interest is fixed for a specific period of time (the term).

Foreclosure: A legal procedure where the lender obtains ownership of the property after the borrower has defaulted on payment.

Gross Debt Service (GDS) Ratio: The percentage of gross income required to cover monthly payments associated with housing. Most lenders recommend that the GDS ratio be no more than 32 per cent of your gross (before tax) monthly income.

High ratio mortgage: If you don't have the 25 per cent required for a down payment, as is the case with a conventional mortgage, your mortgage must be insured against payment default to a certain maximum by CMHC or an approved private insurer. A high-ratio mortgage is a loan in excess of 75 per cent of the lending value of the property.

Lien: The mortgage lender's legal claim to the borrower's property.

Maturity date: Last day of the term of the mortgage agreement.

Mortgage Life insurance: Insurance under which the benefits are used to pay off the balance due on a mortgage upon the death of the insured borrower. The purpose is to protect survivors from losing their home or to provide a debt-free inheritance.

Mortgage loan insurance: For high-ratio mortgages, lenders require mortgage loan insurance. The insurance premium will cost between 0.65 per cent and 3.25 per cent of the amount of the mortgage (additional charges may apply).

Open mortgage: A mortgage in which you can repay the loan, in part or in full, at any time prior to maturity without incurring a pre-payment fee.

Pre-approved mortgage: Preliminary approval by the lender of the borrower's application for a mortgage to a certain maximum amount and rate.

Pre-payment fee: A fee charged by the lender when the borrower prepays all or part of a closed mortgage more quickly than stated in the mortgage agreement.

Principal: The mortgage amount actually borrowed.

Refinance: To pay in full and discharge a mortgage and any other registered encumbrances and arrange for a new mortgage with the same or a different lender.

Second mortgage: A mortgage granted when there is already a mortgage registered against the property.

Security: In the case of mortgages, property offered as backing for the loan.

Term: The length of time a mortgage agreement covers. Payments made may not fully repay the outstanding principal by the end of the term because the amortization period is generally longer.

Title: A legal term that refers to the rightful possession and ownership of property.

Total Debt Service (TDS) Ratio: The percentage of gross income needed to cover monthly payments for housing and all other debts and financing obligations. The total should generally not exceed 40 per cent of gross monthly income.

Variable rate mortgage: A mortgage for which the rate of interest changes as money market conditions change. The regular payments stay the same for a specified period. The amount applied toward the principal, however, changes according to the change (if any) in the rate of interest. Also referred to as a floating rate mortgage.

Vendor-take-back: Where the vendor (seller) of a property provides some or all of the mortgage financing in order to sell the property.

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