Financial Competency

Understanding Mortgages

For most people, buying a home is the biggest purchase of their lives. We want to help you understand the decisions you need to make before you buy, and the options you should consider for how to pay for your home. Your financial advisor can help guide you through this complicated process.

Starting Out

Before you start looking at homes you will need to know:

- The down payment you have available.
- How large a monthly mortgage payment you can afford.
- Other debts and costs you have.
- The price range of homes that meet your needs.

Down Payments

You will need a cash down payment, that is a minimum of 5% of the purchase price. If you have a down payment between 5% and 20% you will need insurance to protect the mortgage lender. The cost of insurance can be included in your mortgage payments. If you have a down payment of more than 20% you will not need insurance.

Monthly Mortgage Payments

Your monthly mortgage payment of principal and interest will depend on:

- Amount borrowed
- Interest rate
- Length of amortization

Other monthly costs

- Property taxes
- Heating
- Potential condominium fees

You should pay no more than 32% of your total gross household income to cover your mortgage payment and these other costs. This is known as your Gross Debt Service Ratio. You should also consider your Total Debt Service Ratio–which is the gross ratio plus the cost of any other monthly payments, such as: car loans, or student debt. Your monthly Total Debt Service Ratio cost should be no more than 40% of your gross income.

Shopping for a Mortgage

If you are in the market for a new mortgage, ask yourself the following question before you make your purchase:

- What are the terms and conditions of the mortgage?
- Do you expect interest rates to rise or fall during the term of the mortgage?
- What type of mortgage do you want?
- Can you afford a shorter amortization period?
- Does the mortgage have a pre-payment penalty if you pay it off before the term is up?

Mortgage Options

Open

An open mortgage means you have the option of repaying any amount of the balance owing, at any time, without penalty. Interest rates are usually higher on open mortgages, but they are a good option if you expect to have the ability to make extra payments.

Fixed

A fixed mortgage means the interest rate will not change during the period of the mortgage. It usually allows the borrower to repay portions of the amount owing without penalties at certain times.

Closed

A closed mortgage doesn't permit extra payments or early repayment. Interest rates are usually lower on closed mortgages.

Variable

The interest rate changes during the term of the mortgage, depending on changes in general interest rates. This is good if rates are falling, but not if they rise.

Amortization Period

This is the length of time it will take to pay off the full amount borrowed. It is typically longer than the term of your mortgage and can be between 20–30 years. The longer the period, the lower your monthly payments, but you pay more interest overall.

Often you can arrange to make weekly or bi-weekly payments, instead of paying monthly. These options can reduce the length of time it takes to pay off your mortgage if you can afford the extra annual costs.

The Effect of Weekly Payments

A comparison between a mortgage of $100,000 with conventional monthly payments and weekly payments:

Mortgage amount of $100,000 at 3% interest calculated on the declining balance	Monthly Payments	Weekly Payments
Payment per period	$473.25	$118.31
Total annual payment	$5,679.00	$6,152.12
Total interest	$41,975.00	$37,192.27
Amortization period	25 years	22.3 years

Interest Rates

The interest you owe on your mortgage is usually calculated on a semi-annual, compounding basis, but it can be calculated using monthly compounding, which costs you more. Be sure to ask your credit union what method they use.

Types of Mortgages

Conventional Mortgage

The loan usually does not exceed 80% of the appraised value or the purchase price. The balance is covered by your cash down payment or a second mortgage. Mortgage insurance is not required.

High-Ratio Mortgage

Refers to a mortgage when the loan exceeds 80% of the purchase price. This type requires insurance which protects the lender in case of default by the borrower.

Second Mortgages

A second mortgage can bridge the gap between the amount you can receive in a first mortgage, conventional or high-ratio, and the purchase price. The interest rate is higher on it, in the event of a default. The first claim against the property belongs to the holder of the first mortgage.

Home Buying Key Terms

Agreement of Sale

The formal document between the seller and you, the purchaser, prepared by a lawyer for registration.

Amortization Period

The number of years over which the repayment of your mortgage is calculated.

Beacon or FICO® Score

Your Beacon, or FICO score is commonly called your credit score. Its a summary of your credit worthiness and is used to determine your credit risk. A score ranges between 300 and 900 with a low score representing an increased credit risk. Traditionally, a good score is considered between 650 and 750.

Closing Date

The date on which the sale of the property becomes final, and the new owner takes possession. At this time, all costs and charges to close the deal are payable.

CMHC

Canada Mortgage and Housing Corporation is the federal Crown corporation that administers the National Housing Act and sells mortgage loan insurance.

Discharge

End of the mortgage upon final payment.

Equity

The value of the property that exceeds the mortgage and other liens against it.

Foreclosure

Court action taken by the lender to take possession of a home if mortgage payments are missed.

HELOC

A home equity line of credit is a collateral mortgage secured by the property. The money can be used for any purpose. It must be paid in full if the property is sold.

Maturity Date

The date on which the mortgage expires. The mortgage must either be paid in full or re-negotiated for another term.

Mortgage Default Insurance

It is required on mortgages of more than 80% of the purchase price.

Offer to Purchase and Interim Agreement

These are initial documents prepared by your real estate agent that tie the seller and purchaser until final documents are prepared by a lawyer.

Pre-payment Penalty

Refers to the amount that must be paid if you want to pay off the mortgage early. Some agreements allow you to prepay set amounts during the term of the mortgage.

Principal

The amount borrowed under the mortgage. Monthly payments include an amount to pay the principal and interest costs.

Term

Term refers to the length of your mortgage. It can be a few months to several years and usually does not cover the full amortization period.

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