
Mortgage Financing Basics



Pre-Approved Mortgages

All buyers should get pre-approval from a financial institution BEFORE they begin their house search. It costs nothing. Further, it may allow you to write a "non-subject" offer on a home. This is especially important when you are in competition with another buyer.

With pre-approval, your lender approves the amount of your mortgage and gives you a written confirmation or certificate for a fixed time period before you start looking for a home. The pre-approval term, usually lasting from 60 to 90 days, also sets the mortgage interest rate the lender will offer to you. If rates go down in that period, the lender should offer you the new lower rate. Make sure that they do! Pre-approval gives you a head start on house hunting, but your final approval is still subject to a bank appraisal of the value of the home.

What a Lender wants from you

Lenders want plenty of financial information about you and your spouse to assess your ability to repay the loan. This ability is based on your gross income and also on your assets, liabilities, earnings, employment history and your past record of repaying loans. Specifically, your lender may want the following:

- Personal information – age, marital status, dependents;
- Details of employment including proof of income (T-4 slips, personal income tax returns or a letter of verification from your employer);
- Other sources of income i.e. pensions or rental income;
- Current banking information;
- Verification of your down payment;
- Consent to run a credit investigation;
- A list of assets, including property and vehicles;
- A list of liabilities i.e. credit card balances, car loans – the total amount you owe and your monthly payment amounts;
- If you are getting the down payment from someone (i.e. your parents), then the bank will want a note from them saying that the monies are a "gift." If you have to repay this money, it is considered a liability not an asset.

Consider Hiring a Mortgage Broker

Every mortgage broker in Canada is online with all of the major lenders and can get you pre-approved or completely approved within 24 to 48 hours of taking the application.



If you have a less than perfect credit rating or need creative financing and you don't qualify with conventional lenders, a mortgage broker's expertise will come in to play.

If you are difficult to finance, they may charge a fee for their services but otherwise, the Lenders will pay a mortgage broker a commission for sending you to them.

What is the income required should there be an interest rate hike?

Our test case is a home priced at \$238,040. A five percent down payment of \$11,902 and a mortgage rate of 6.4% for a five year term and 25 year amortization rate (including mortgage insurance fee) applies here. You would pay a monthly payment of \$1,501. and would need an income of \$59,500 to qualify for the mortgage. So look at the difference if we apply a one, two and five percent increase to the interest rate.

Interest Rate	Monthly Payment	Income Required
7.4	\$1,640	\$65,000
8.4	\$1,784	\$70,650
11.4	\$2,239	\$88,700

Don't Miss Out!

For every \$1,000.00 borrowed you will pay just \$6.40 per month! (calculated on a 6% interest rate).

Is it worth it for you to miss out on the house of your dreams because you did not want to pay \$5,000.00 more for it? This calculates to \$32.00 extra per month or \$1.03 per day!

Monthly payment per \$1,000.00 borrowed			
<u>Interest rate (%)</u>	<u>Cost per \$1,000</u>	<u>Interest Rate (%)</u>	<u>Cost per \$1,000</u>
4.5	\$5.53	7.0	\$7.01
5.0	\$5.82	7.5	\$7.32
5.5	\$6.10	8.0	\$7.64
6.0	\$6.40	8.5	\$7.96
6.5	\$6.70	9.0	\$8.28

Amortized over 25 years

Conventional or High Ratio?

Depending on the amount of your down payment, you will have either a conventional or a high ratio mortgage.

*** Conventional Mortgage**

This mortgage is for an amount which does not exceed 75% of either the appraised value of the property or the purchase price, whichever is lower. Your down payment is a minimum of 25% of the purchase price.

*** High-Ratio Mortgage**

With this type of mortgage, your down payment is less than 25% of the cost of the home to as little as 5%. A high-ratio mortgage requires mortgage loan insurance. CMHC or GE Mortgage Insurance offers it for a percentage of the mortgage amount. This premium can be added to your mortgage payments and amortized over 25 years or paid in full on closing.

There are two insurance companies:

- 1) CMHC or Canada Mortgage and Housing Corporation
- 2) GE Mortgage Insurance Canada. This is the largest private sector mortgage insurance company.

Both can insure Lenders against a buyer's default.

Types of Mortgages

Although there are more options, an Open, Closed or Variable rate mortgage are the most common.

Open Mortgage

This means you can repay the loan, in part or in full, at any time without penalty. Interest rates are usually higher on this type of loan. An open mortgage can be a good choice if you plan to sell your home in the near future. Most lenders will allow you to convert to a closed mortgage at any time. Many experts suggest taking an open mortgage for a short term in times of high rates and converting to a longer term when rates fall.

Closed Mortgage

A closed mortgage usually offers the lowest interest rate available. It's a good choice if you'd like to have a fixed rate to work your budget around for a few years. However, closed mortgages are not flexible and there are often penalties or restrictive conditions attached to prepayments or additional lump sum payments. If you move before the end of the term, you most probably will have a "payout" penalty.

Variable Rate Mortgage

If you want to take advantage of potential declining interest rates then consider the advantages of a variable rate mortgage. Your interest rate will fluctuate with the prime rate each month meaning that the portion of your monthly payment that goes towards interest may go up or down each month. However, your total monthly payment will probably stay the same. Variable rate terms are open and may be repaid in full or converted to a closed mortgage without penalty (a small bank fee may be charged though). Usually, you will have your choice of payment frequencies. Obviously, one has to be astute and "lock in" before interest rates become too high if you favour this option.

Mortgage Options

Once you have decided on the type of mortgage you will be choosing, you then have to decide on the interest rate, term, amortization period and payment frequency. You can save a lot of money if you are astute in your choices.



Rate of Interest

This is the percentage interest that you pay on top of the loan principal. For example, you may take out a mortgage of \$100,000 at a rate of 6%. Your monthly payments will consist of a portion of the original \$100,000, plus 6% interest.

Term

The term of a mortgage is the length of time that you will pay a set interest rate. Terms usually last anywhere from six months to ten years. At the end of the term you either pay off your mortgage or renew it at current interest rates.

Amortization

This is the amount of time over which the entire debt will be repaid. Most mortgages are amortized over 15, 20 or 25 year periods. The longer the amortization, the lower your scheduled mortgage payments, but the more interest you pay in the long run. You don't automatically qualify for a shorter amortization period – this will depend on your gross income. If you qualify, think about selecting a shorter amortization at renewal.

Payment comparison over various amortization periods*

A shorter amortization means savings on interest payments. This example is based on a \$80,000. mortgage amortized over 25 years and the example below – 15 years.

<u>Interest Rate</u>	<u>Monthly Payment</u>	<u>Total Repaid*</u>	<u>Total Interest Cost*</u>
5%	\$465.29	\$139,583	\$ 59,583
7%	\$560.34	\$168,096	\$ 88,096
9%	\$662.39	\$198,709	\$118,709

15 Year Amortization

<u>Interest Rate</u>	<u>Monthly Payment</u>	<u>Total Repaid*</u>	<u>Total Interest Cost*</u>
5%	\$630.50	\$113,490	\$ 33,490
7%	\$714.60	\$128,628	\$ 48,628
9%	\$803.62	\$144,650	\$ 64,650

*Calculated assuming a constant interest rate throughout the amortization period over the life of the mortgage. Compounded, semi-annually not in advance.

Schedule of Payments

A mortgage loan is repaid in regular payments, i.e. monthly, biweekly, weekly, etc. The more frequent payment schedules can save you money by reducing the principle amount borrowed, quicker. The more payments in a year, the lower the overall amount of interest you will pay on your mortgage.

Payment Frequency

This example is based on an \$80,000 mortgage, 25 year amortization and an 8% interest rate. Assumes a constant interest rate throughout the amortization period – compounded semi-annually, not in advance.

	Payment	Total Interest Cost	Mortgage Free
Monthly Payment (12 per year)	\$610.58	\$103,165	25 years
Biweekly Payment (26 per year)	\$281.81	\$101,125	24 years/7 months
Weekly Payment (52 per year)	\$140.91	\$100,697	24 years/6 months
Accelerated	\$305.29	\$ 78.167	19 years/9 months

In this example, choosing accelerated payments instead of monthly payments on an \$80,000 mortgage would save you \$24,998. and cut more than 5 years off the life of your mortgage.

Incentives?

Cash-back mortgages

Some lenders offer cash back to a buyer when they take out a mortgage with them. Buyers will often use this money towards new furniture, renovations or closing costs. However, keep in mind that not only will you be required to pay the posted rates for your mortgage but there will also be some restrictions. When mortgage holders sell their home before their “term” is up, they have to repay the Lender a portion of the cash back – depending on the time remaining on the term.

