

Getting Started

Before you begin your house search you should take the time to gain some understanding of the mortgage financing process. Although a great deal of information is available in books and online it is a good idea to speak to a Mortgage Professional in person about your particular situation. They will be happy to sit down and explain the process at no charge and with no obligation. You should know in advance what information lenders will want in order to qualify you for a mortgage. It is also important to get **pre-approved** before any serious house hunting begins. This will guarantee your interest rate for up to 120 days and allow you to focus your search in the correct price range.

The Pre-approval

This is the most important part of the entire mortgage process. Getting pre-approved before you begin house shopping will accomplish several objectives. First of all, you can shop in confidence knowing you qualify for a mortgage and you will know the maximum you can spend. With this knowledge you can focus your search in the right price range and act quickly when you find the home you want. The rate offered with your pre-approval is **guaranteed** for up to 120 days even if rates have gone up over that time. If rates go down you will get the lowest rate in effect throughout the entire pre-approval period.

It is also important that you get a **real** pre-approval where your credit is checked up front and an attempt is made to confirm income and down payment before the pre-approval request is sent in. Many financial institutions will issue a rate hold or rate guarantee without **pulling** a credit bureau or confirming income. This can be problematic since the actual mortgage commitment will be subject to a minimum credit score and verification of the information provided at the time of the application. It is much better to know from the beginning that your pre-approval is firm and nothing has been left to chance. A mortgage broker is required to check credit before submitting an application to a lender and will let you know if there are any concerns and what needs to be done to get your credit back on track if this is necessary.

The pre-approval is based on your financial situation at the time of your application. **It is important not to increase debt levels or miss any payments prior to closing** and any changes to your employment situation or the employment situation of a co-applicant should be discussed with your Mortgage Professional.

Down Payment Options

Banks and other lending institutions prefer that borrowers put some of their own hard earned money toward their purchase in the form of a down payment. Generally speaking, the larger the down payment the easier it is to obtain mortgage approval. This is because lender risk decreases as the down payment increases. Lenders will want to see three months bank or investment statements showing a steady accumulation of funds for the down payment and closing costs. They want to ensure that the money is not coming from a loan source requiring repayment and any unusually large sums appearing on the statements will require an explanation.

The government recently eliminated 100% financing as an option for Canadian homebuyers. However, alternatives still do exist for buyers who haven't been able to save enough for the **minimum 5% down payment**. The following down payment options offer solutions for those who qualify.

GIFTED DOWN PAYMENT:

Lenders will allow the down payment to come from immediate family members (parents, grandparents or siblings) in the form of a **gift**. Parents or grandparents will often help a child or grandchild with their first home purchase without any expectation of repayment. The family member must fill out and sign a gift letter confirming that the funds are indeed gifted. If the money came from anyone else (ie: friend or co-worker), it would be treated as a loan since non-family members usually expect to be repaid at some point in the future.

BORROWED DOWN PAYMENT:

If the homebuyer has sufficient income, the lender may allow the down payment to be **borrowed** as long as the payment is included in the total debt service ratio and total debt payments remain below a set percentage of income. Mortgage insurers charge a slightly higher premium to insure this type of mortgage (2.9% vs 2.75%).

CASH BACK MORTGAGES:

There are two basic kinds of **cash back** mortgages. With one type, the borrower must come up with the down payment in the traditional manner. Shortly after closing they would receive a cheque from the lender for a predetermined sum (usually 3 to 5% of the mortgage amount). A credit score above 600 is required to qualify.

With the other type, you don't need money for the down payment but you will need enough to cover closing costs. The lender will send the money for the 5% down payment to the lawyer on closing. The credit score requirement for this mortgage is higher (650+). In both cases, the interest rate is higher so that the lender is able to recoup the cash back amount plus interest over the term of the mortgage. If the borrower exits the mortgage before the end of the term, the lender will 'claw back' whatever amount has not been recovered.

If you don't have a down payment you may qualify for one of the above alternatives. A qualified Mortgage Professional will help you choose the option that is most suitable in your particular situation.

Home Buyers' Plan

The Home Buyers Plan (HBP) is a government program that allows first-time homebuyers to withdraw up to \$25,000 tax free from their RRSP (\$50,000 per couple) to purchase or build a home. The funds can be used for the down payment or for purchase related items such as furniture, moving expenses or closing costs.

There are a number of qualifying requirements with respect to this program. Here are a few of them:

- You must be a resident of Canada and the home must be your principal residence.
- The funds must be in your RRSP for a minimum of 90 days.
- To be eligible you cannot have owned a home in the preceding 5 years.
- You must replenish your RRSP over a 15 year period, or sooner, to avoid paying tax.
- If you marry someone who has used the plan and you move into their home you are no longer eligible for the program. One family, one principal residence.

For more information on the Home Buyers Plan go to www.cra-arc.gc.ca

Mortgage Insurance

Most major lenders, including banks, are limited to lending no more than 80% of the value of property unless the mortgage is insured. This insurance, called mortgage default insurance, protects the lender against loss but is paid for by the borrower. Currently only three companies provide this type of insurance in Canada - **Canada Mortgage and Housing Corporation (CMHC)**, **Genworth** and **AIG United Guaranty**. The insurance premium is a one time charge and in most cases it is added to the mortgage after the down payment is applied. If the borrower has 20% or more to put down mortgage insurance is not required.

The premium is expressed as a percentage of the loan amount with the percentage increasing as the **Loan-To-Value (LTV)** increases. Here is a sampling of current premiums for purchase transactions:

Loan-to-Value Ratio	Premium on Loan Amount	
From 80.01% up to and including 85% (15% down)	1.75%	Premiums quoted are based on a 25 year amortization - add .20 for a 30 year and .40 for a 35 year amortization.
From 85.01% up to and including 90% (10% down)	2.00%	
From 90.01% up to and including 95% (5% down)	2.75%	
Cash Back & Borrowed Down Payment	2.90%	

If a borrower has a 5% down payment with a 25 year amortization the premium would be **2.75%** of the loan amount. For example, if the purchase price is **\$180,000** and the down payment is **5%** or **\$9,000** the basic loan amount would be **\$171,000** (\$180,000-\$9,000) and the insurance premium would be **\$4,702.50** (2.75% of \$171,000). This is a significant amount of money and most people choose to add it to their mortgage since they have already had to save a substantial amount for the down payment and closing costs. When the premium is added to the mortgage the total mortgage amount is calculated as follows:

Purchase Price – Down Payment + Mortgage Insurance = Mortgage Amount.

Using the above example: **\$180,000 - \$9,000 + \$4,702.50 = \$175,702.50**

Closing Costs

In addition to the down payment the house buyer must have enough cash or liquid assets available to pay for closing costs. These costs will vary depending on the lender and mortgage particulars as well as the purchase price, type and location of the property. They will include many, if not all, of the following: **legal fees and disbursements, land transfer tax, PST** on the mortgage insurance premium, **title insurance, inspection, appraisal, interest adjustment, tax adjustment** if the vendor has pre-paid property taxes and **tax holdback** if the lender is collecting taxes on behalf of the buyer. If the purchase involves a property with oil heat the buyer must also pay for a full tank of oil.

Lenders don't know exactly how much a homebuyer will need for closing costs because these costs vary with each purchase. However, they will want to see that you have at least **1.5%** of the purchase price in a bank or investment account to cover these expenses.

The government recently eliminated **land transfer tax** for **all** first-time homebuyers. This is a significant since the land transfer tax amounted to about 1% of the purchase price. Buyers who are not first timers must still pay this tax.

The following page illustrates a sample breakdown of closing costs using the above example of a **\$180,000** house purchase with a **5%** down payment. In this case the insurance premium has been added to the mortgage which is what most people choose to do.

When You Find the Home You Want

When you find the home you want to buy your real estate agent will prepare an **Offer To Purchase**. This is a legally binding agreement between you and the vendor. Your agent will present the offer along with your deposit to the real estate agent of the vendor. The deposit will be applied to the purchase if the offer is accepted and is credited toward the total amount needed to cover the down payment and closing costs.

An offer can contain many different clauses or conditions and your realtor will help determine which ones you require. **It is important to ensure that the offer has a condition allowing you to arrange satisfactory financing even if you have been pre-approved.** This allows time to obtain approval from the mortgage insurer and finalize the approval with the lender.

When the **Purchase and Sale Agreement** has been signed by both parties ask your realtor to fax or email it, along with the **MLS Listing**, to your Mortgage Professional who will forward them to the lender with an application detailing the actual property and mortgage information. The lender will review the Purchase Agreement and property information and, if everything is satisfactory, send back a **Mortgage Commitment**. The commitment will outline the terms and conditions of your mortgage including a list of required documentation as well as instructions for your solicitor. You will be asked to sign the commitment and submit the required documents to the lender by a specified date. These documents usually include proof of employment and income and confirmation of funds to cover the down payment and closing costs. The information requested will vary depending on your particular situation, the mortgage product you have chosen and the lending institution in question. Your Mortgage Professional will give you a good idea of what paperwork will be needed when you are pre-approved and you should begin collecting it then to avoid any additional stress as closing day approaches.

After the lender has received and checked all the documentation they will send a set of **Mortgage Instructions** to your solicitor. The solicitor will call you to make an appointment to sign the final mortgage documents and ask you to bring a bank draft or certified cheque in the exact amount needed to close.

Product Choices

The Canadian mortgage industry has become increasingly competitive in recent years with the arrival of new lending institutions and many new product offerings. Buyers can now choose from a wide assortment of fixed and variable rate options including re-advanceable mortgages (mortgage combined with a line of credit). New product enhancements have made it easier to obtain a mortgage for second home, vacation and rental property purchases. Other new offerings include mortgages specifically designed for business owners who have difficulty proving income and individuals who are new to Canada.

Mortgages are now available with 15, 18 and 25 year terms and others with 30 and 35 year amortizations. Longer amortizations enable some people to enter the housing market sooner and others to qualify at a higher purchase price. While the additional interest over the extended amortization period can be costly, so can waiting to make a purchase in an rising housing price market. Also, most mortgages come with generous pre-payment privileges which will allow you to reduce your amortization when earnings increase or extra cash becomes available.

No lender offers all products and no single bank or lending institution always has the lowest interest rate. This is why the services of a qualified mortgage broker can be so valuable. A broker has access to the rates and mortgage products of many lenders including major banks and can help you sort through the options to find the best product for you at the lowest rate available in the marketplace.

What Lenders Will Be Looking For

Lenders and mortgage insurers examine **three main areas** to determine whether or not to grant mortgage approval and how large that mortgage can be.

1. FINANCIAL ABILITY TO REPAY THE LOAN:

Lenders and insurers want to see that borrowers have steady jobs and sufficient income to handle their current debt obligations as well as the costs associated with owning a home. When the down payment is less than 20% of the purchase price (most first-time buyers) the mortgage must be insured against default. The three providers of default insurance, CMHC, Genworth and AIG, set the formula for borrower qualification and two key measurements are used to determine the maximum mortgage amount allowable. The first qualifying measurement called the **Gross Debt Service** ratio (GDS) compares housing costs to the total gross income of all applicant. These housing costs, which include the monthly mortgage payment and an amount to cover property taxes and heat, generally cannot exceed 35% of monthly income when credit scores are less than 680. When credit scores are 680 and above no GDS measurement is required.

The other key qualifying measurement called the **Total Debt Service** ratio (TDS) compares total monthly debt obligations to monthly income. Total debt includes the new housing costs and other regular monthly payments such as car loans and leases, lines of credit and credit card payments. The total of these debt payments cannot exceed 42% of gross monthly income if credit scores are less than 680 and 44% when scores are above 680. These two ratios are used to determine the maximum the lender will advance and thus the maximum amount the purchaser should consider when shopping for a home.

The maximum the lender will allow could be higher than your own personal maximum. You may qualify for a mortgage and payment amount that is beyond your comfort level. If you are currently renting you should have some idea of what payment amount would be affordable given your lifestyle and taking into consideration the additional expenses associated with home ownership, such as taxes, utilities and maintenance. The following chart matches mortgage amounts with corresponding monthly mortgage payments using a **35 year** amortization and a **5 year** interest rate of **4.49%**. It shows what you can expect to pay and may help you determine the mortgage amount that matches your comfort payment limit. The lender limit is based on credit score, down payment amount and ratio analysis and could be higher or lower than your personal maximum.

MORTGAGE AMOUNT	MONTHLY PAYMENT
\$140,000	\$658.11
\$150,000	\$705.11
\$160,000	\$752.12
\$170,000	\$799.13
\$180,000	\$846.14
\$190,000	\$893.15

MORTGAGE AMOUNT	MONTHLY PAYMENT
\$200,000	\$940.15
\$210,000	\$987.16
\$220,000	\$1034.17
\$230,000	\$1081.18
\$240,000	\$1128.18
\$250,000	\$1175.19

2. THE PROPERTY:

Lenders and insurers have certain requirements with regard to the value and marketability of the property being purchased as this is the security for their loan. They will avoid properties with any serious safety or liability issues such as urea formaldehyde insulation, mould or structural instability. To determine value the lender will either order an appraisal or obtain an automated valuation using electronic data base information. If the mortgage is insured (when the down payment is less than 20%), the insurer will confirm value. This is done to verify that the property is worth enough to cover the outstanding mortgage balance should default occur. The loan amount will be based on the **lesser** of the appraised value or sale price of the house.

The lender will ask the lawyer to do a search to ensure that there are no outstanding liens or encumbrances registered against the property and will require a survey and/or title insurance to protect against any other title defect or irregularity.

With high ratio mortgages the lender will often insist on collecting a monthly property tax component from the borrower to ensure that taxes are paid on time. This is because the tax collector (government) has first right to title when taxes are in arrears. In the event of foreclosure, the lender and mortgage insurer could suffer unnecessary losses if they fail to see that taxes have been kept up-to-date.

3. CREDIT WORTHINESS:

Lenders analyse credit reports from two credit reporting agencies (**Equifax** and **TransUnion**) to determine credit worthiness or default risk. The purpose of this analysis is to provide information on the past payment behaviour of the applicant in order to assess the likelihood that this behaviour will continue in the future. A great deal of consideration is given to the credit report when applying for a mortgage. Every time you make a loan or credit card payment it is reported to these two agencies and shows up on your personal credit report or bureau. Every late or missed payment is also reported and will have a negative impact on your credit score (also called **beacon** or **fico** score). Bankruptcy, collections and judgements are very damaging to credit standing and take a good deal of time to repair. Other things that adversely affect your score include having a large number of accounts with outstanding balances, continuously keeping balances close to their credit limits, exceeding credit limits and large numbers of inquiries. Scores range from 300 to 850 and the higher the better. A good credit score is very important as it will be used to determine whether or not an applicant qualifies for a mortgage and can affect the amount of the loan as well as the interest rate charged. A minimum score of 600 is required to obtain mortgage approval. Many people believe that not using credit is a good thing and makes them a strong candidate for future credit. In fact, the opposite is true. If you have no past credit history or current credit usage on record it is very difficult to obtain a mortgage.

You can get a copy of your credit report (with beacon score) from Equifax Canada for \$23.95. You should review your report periodically to ensure that the information is accurate. Occasionally credit information belonging to someone else can end up on your report and negatively affect your score. It is a good idea to get a copy when you first consider home ownership so you have some idea of your credit status before applying for a mortgage. You can obtain a copy by calling **800-465-7166** or online at www.equifax.ca.

For more information on the **Mortgage Financing Process** please contact **Janet MacDonald** at 613-561-5047 janet@mtgprof.com, **Colin Birkas** at 613-929-7629 colin@mtgprof.com, or **Jeff Dillon** at 613-453-3663 jeff@mtgprof.com.

Common Mortgage Terminology

AMORTIZATION:

The length of time required to reduce a mortgage debt to zero if the interest rate and payments remained the same. Until recently 25 years was the maximum, but now 30 and 35 year amortizations are also available.

CONVENTIONAL MORTGAGE:

A mortgage loan to a maximum of 80% of the lending value of the property. Mortgage loan insurance is not required for this type of mortgage.

CLOSED MORTGAGE:

A mortgage that cannot be paid off or renegotiated before the end of the term without paying a penalty – usually 3 months interest or the interest rate differential (whichever is greater).

FIXED RATE MORTGAGE:

A mortgage in which the rate of interest has been fixed for a specific period of time (term).

HIGH-RATIO MORTGAGE:

Any mortgage where the purchaser is supplying less than 20% for a down payment. The mortgage must be insured against default by CMHC or Genworth.

LOAN TO VALUE RATIO (LTV):

The ratio of the loan to the lending value of the property expressed as a percentage. For example, if a property is worth \$200,000 and the mortgage is \$160,000 the LTV is 80%.

MATURITY DATE:

The last day of the TERM of the mortgage agreement. On this day you must either pay off the loan, renew it with the same lender or move it to another lender for another term.

MORTGAGE INSURANCE:

If your mortgage is hi-ratio (greater than 80% of the purchase price), you must have mortgage loan or default insurance. The insurance premium is a one time charge that can either be paid up front or added to the loan amount and paid as part of the regular monthly payment.

MORTGAGE LIFE INSURANCE:

This insurance guarantees that if any person with coverage dies the mortgage will be paid in full. It is available through the lender or broker and the premium is added to your monthly payments. However, you may wish to compare rates for equivalent products through an insurance agent.

OPEN MORTGAGE:

A mortgage that can be renegotiated, prepaid in any amount or paid off at any time without penalty. The interest rate is usually higher than a closed mortgage with the same term.

TERM:

The contract period or length of time that the mortgage conditions, including interest rate, are in effect. Terms are usually between 6 months and 10 years, although mortgages are now available with terms up to 25 years.

TITLE INSURANCE:

Protects against loss or damage caused by occurrences affecting title to the property. This could include, but is not limited to, a defect in title or the existence of a lien or encumbrance.

VARIABLE RATE MORTGAGE:

A mortgage with an interest rate that fluctuates with the Prime lending rate.