Financial Consumer Agency of Canada
Agence de la consommation en matière financière du Canada

ABCs OF MORTGAGES SERIES

BUYING YOUR FIRST HOME: THREE STEPS TO SUCCESSFUL MORTGAGE SHOPPING

Smart mortgage decisions start here

Financial Consumer Agency of Canada
IT PAYS TO KNOW.

Canada

About Financial Consumer Agency of Canada (FCAC)

With educational materials and interactive tools, the Financial Consumer Agency of Canada (FCAC) provides objective information about financial products and services to help Canadians increase their financial knowledge and confidence in managing their personal finances. FCAC informs consumers about their rights and responsibilities when dealing with banks and federally regulated trust, loan and insurance companies. FCAC also makes sure that federally regulated financial institutions, payment card network operators and external complaints bodies comply with legislation and industry commitments intended to protect consumers.

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OVERVIEW

Buying a home is probably the biggest financial decision you will ever make, and for most people, it requires getting a mortgage. You can follow three steps to make sure you get the mortgage that's best for you:

- figuring out what features you need and want in a mortgage;
- getting pre-approved for a mortgage; and
- understanding your rights when you apply for a mortgage.

You have decided that you want to purchase a home. There are some important questions you need to ask yourself before and during the mortgage process such as:

- How much of a down payment do you have?
- What price range for a home is within your budget?
- Have you considered all the costs involved with owning a home, such as
  - mortgage payments
  - utility costs
  - property taxes, and
  - maintenance costs?
- Are you expecting any big changes that will affect your household budget in the near future? For example, are you planning on starting a family or adding other expenses, such as car payments, that would affect your budget?

This publication will help you get prepared for buying your first home.

STEP 1: KNOW WHAT YOU NEED AND WANT IN A MORTGAGE

A mortgage is probably the single largest amount you will ever borrow. It is important to know how mortgages work, and what you need and want in a mortgage **before** shopping around for one.

DOWN PAYMENT

A down payment is the amount of money that you pay at the time of purchase toward the price of your home (your mortgage loan covers the rest). **You should have a good idea of how much you can put toward the down payment before talking to a potential lender or mortgage broker.**

The minimum down payment for the purchase of a home depends on a number of factors like the type of home, but it is **at least 5% of the purchase price of the home**. For example, to buy a home for $200,000, you will need a minimum of $10,000 as your down payment.

Normally, the minimum down payment must come from your own funds. You may be eligible for other loans to help you come up with the down payment. However, it is always better to save for a down payment to minimize your debts.

You may also be eligible for the Home Buyers' Plan (HBP) to help you make the down payment on your home, if you have investments in Registered Retirement Savings Plans (RRSPs). See page 5 for more information on the HBP.

Where can your down payment come from?

Your down payment can come from

- chequing or savings accounts
- Canada Savings Bonds
- guaranteed investment certificates (GICs)
- stocks, bonds, and other non-registered investments
- Tax-Free Savings Account (TFSA)
- RRSP (under the Home Buyers' Plan)
- gifts from family, or
- other assets.

Remember

- **It is better to put as big a down payment as possible to save you money on interest charges.**
- **If your down payment is less than 20%, you will have to get mortgage default insurance. For more information on mortgage default insurance, see page 18.**

DOWN PAYMENT FINANCING OPTION: HOME BUYERS' PLAN

If you are a first-time home buyer, the Home Buyers' Plan (HBP) allows you to withdraw money from your Registered Retirement Savings Plan (RRSP) tax-free to make your down payment. The HBP is administered by the Canada Revenue Agency (CRA).

There are certain conditions you must meet to be eligible for the HBP. For more information, contact CRA at www.cra.gc.ca.

How much can you withdraw?

- You can withdraw up to $25,000 from your RRSP.
- If you buy the home together with your spouse, partner, or someone else, each of you can withdraw up to $25,000, for a total of up to $50,000.
- The withdrawal from your RRSP does not need to be included in your income on your annual income tax return, and no tax is taken off the money you withdraw.

What is the payback period?

- You don't have to start paying back the money to your RRSP until two years after the purchase of the home.
- You must pay back all withdrawals from your RRSP within 15 years by making RRSP deposits each year, starting the second year following your withdrawal. CRA will determine what your minimum yearly repayment will be and will notify you once you need to start repaying the amount.
- If you do not repay the amount due in a given year, it is included in your taxable income for that year and you'll have to pay income tax on this amount.

EXAMPLE: HBP REIMBURSEMENT

In 2010, Martin withdraws $6,000 from his RRSP to participate in the HBP to buy a home. Martin's minimum yearly repayment to his RRSP, starting in 2012 (two years after purchase), will be $400 ($6,000 ÷ 15 years).

If Martin decides not to make any reimbursement in 2012, he will have to include $400 in his income when he files his 2012 income tax return. His minimum yearly HBP repayment, however, will remain at $400 for the following years.

On the other hand, if Martin decides to make a HBP reimbursement of $1,000 to his RRSP in 2012, his minimum yearly repayment for 2013 and the following years will be $357.14 ([$6,000 – $1,000] ÷ 14 years).

Questions you should ask yourself

- **Will you be able to make the annual repayment to your RRSP each year?**

  If not, using your RRSP funds to purchase a home can cost you a lot in income tax.

- **Can you avoid paying mortgage default insurance by using your RRSP investments to increase your down payment?**

  If so, the savings may be significant. See the section on mortgage default insurance on page 18 for more information.

Your financial advisor can help you find answers to these and other questions that you may have.

MORTGAGE PAYMENTS: UNDERSTANDING INTEREST VERSUS PRINCIPAL

How the payment is split between interest and principal

For each mortgage payment you make, the money is first used to pay the interest on your mortgage loan. The remaining portion of your payment is then used to reduce the principal, which is the amount that you borrowed from the lender.

In the first years of the mortgage, most of the payment is usually required to cover interest costs. As a result, the principal, or the amount that you owe, may decrease by only a small amount. As the mortgage balance decreases over time, more of your payment is used to pay off the principal.

During a 25-year mortgage, depending on the interest rates charged on your mortgage, the total amount of your payments could be double the amount that you originally borrowed, or even more.

The key to saving money on your mortgage is to pay off the principal as fast as possible. If your household budget allows you to reduce the time you need to pay your mortgage in full, you could save thousands, or even tens of thousands of dollars in interest charges.

You can learn more about some payment options that will help you pay off your mortgage faster in the pages that follow.

CHOOSING AN AMORTIZATION PERIOD

The amortization period is the length of time it takes to pay off a mortgage in full.

If your down payment is less than 20 percent of the purchase price of your home, the longest amortization period allowed is 25 years.

Although a longer amortization period means lower mortgage payments, **it is to your advantage to choose the shortest amortization – that is, the largest mortgage payments – that you can afford**. You will pay off your mortgage faster and will save thousands or even tens of thousands of dollars in interest in the long run.

The following table shows how much interest is paid (over different amortization periods) on a $150,000 mortgage, assuming a constant annual interest rate of 5.45%.

Impact of amortization on total interest paid

Mortgage amount	Amortization	Monthly payment	Total interest paid
$150,000	**25 years**	$911	**$123,368**
$150,000	**20 years**	$1,022	**$95,391**
$150,000	**15 years**	$1,217	**$69,027**
$150,000	**10 years**	$1,620	**$44,360**

In the example on the previous page:

- increasing your payment by just $111 from $911 to $1,022 per month means you would be mortgage-free **five years** earlier and save almost **$28,000 in interest charges**;
- increasing the monthly payment by $306 from $911 to $1,217 would allow you to be mortgage-free **10 years** earlier and save over **$54,000 in interest**.

There are other ways to pay less interest, such as accelerated payment options. You can find more details about these in the section "Frequency of payments," starting on page 15.

CHOOSING A MORTGAGE TERM AND TYPE

The mortgage term is the length of time your mortgage agreement will be in effect (for example, five years). At the end of each term, you will need to renew or renegotiate your mortgage, unless you are able to pay it off fully at that time.

Lenders frequently offer two types of mortgages for various terms: open and closed.

The main difference between open and closed mortgages is the amount of flexibility you have in making extra payments on the principal or in paying off the mortgage completely. These types of extra payments on a mortgage are often called prepayments.

Open mortgages

With an **open** mortgage agreement:

- you can make prepayments at any time during the term, or even pay the mortgage off completely before the end of the term, without having to pay any penalty;
- the interest rate on an open mortgage **is usually higher** than on a closed mortgage with a comparable term length.

Closed mortgages

With a **closed** mortgage agreement:

- if you want to change your mortgage agreement during the term (for example, to take advantage of lower interest rates), you will usually have to pay a penalty to break your mortgage term agreement;

- the mortgage lender may let you make prepayments without penalty;
  - prepayment privileges on closed mortgages vary from lender to lender. For example, one lender might let you put a 10% lump sum payment every year, while another might only let you put 5% down every year.
- the interest rate on a closed mortgage **is usually lower** than on an open mortgage with a comparable term length.

For more information on prepayment privileges, see FCAC's publication, *Paying Off Your Mortgage Faster*.

UNDERSTANDING FIXED AND VARIABLE INTEREST RATES

What are your options?

When you apply for a mortgage, lenders may offer you options with either fixed or variable interest rates.

Note: The type of interest rate (fixed or variable) is decided separately from the type (open or closed) described in the previous section.

Fixed interest rate mortgages

With a fixed interest rate mortgage, the interest rate is determined when you apply for a mortgage. This interest rate is set for the entire term. The amount of your regular mortgage payments is also fixed.

Because the interest rate does not change throughout the term, you know in advance the amount of interest you will have to pay (assuming you don't make any prepayments), and therefore how much of the original loan amount will be paid off during the term.

Variable interest rate mortgages

A variable interest rate mortgage is a mortgage loan with an interest rate that can change during the term. The interest rate varies with changes in market interest rates. Because mortgage payments and interest rates can change, **it is impossible to know in advance how much of your original loan will be paid off during your term**. However, your mortgage lender will give you an estimate based on the variable rate at the beginning of your term.

With a variable interest rate mortgage, the amount of the payments can be

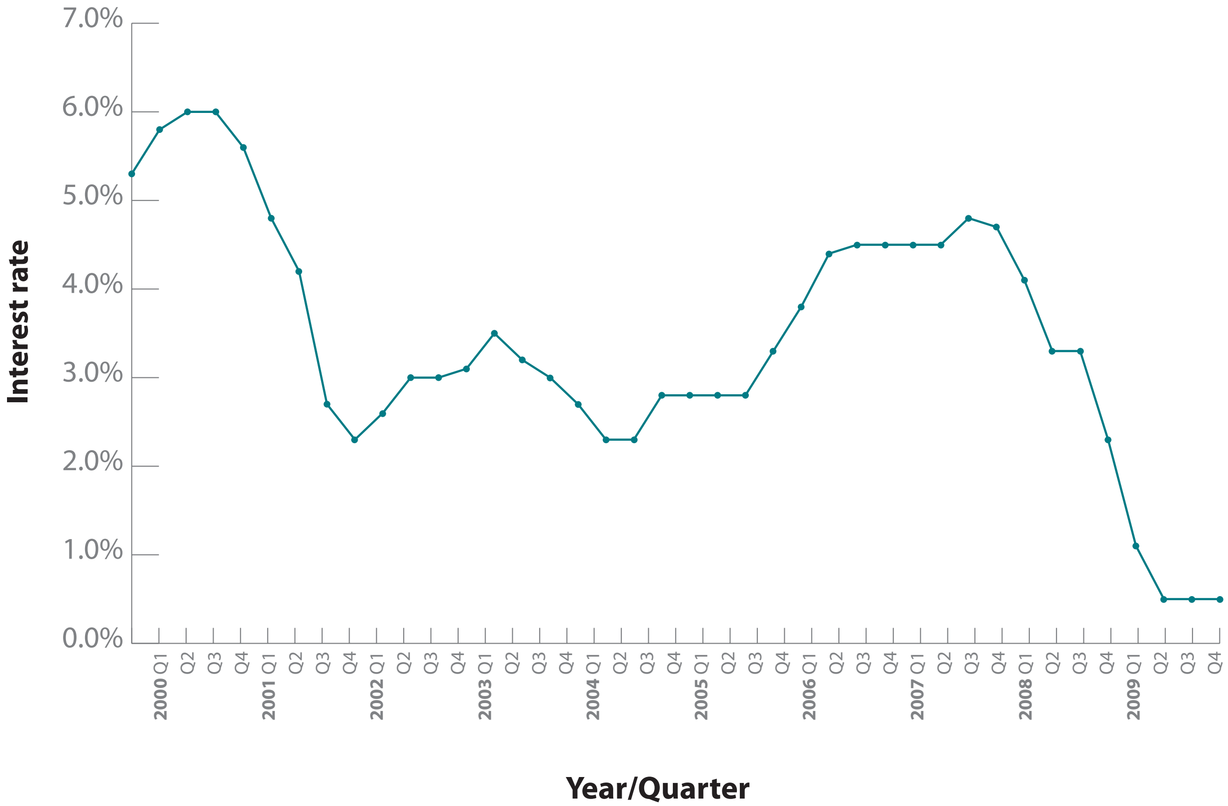
- fixed, or
- variable (i.e. the amount of the payment would change when interest rates change).

It depends on the lender and the terms of the mortgage agreement.

The interest rates on variable rate mortgages are often lower than on fixed interest rate mortgages with the same term length when you sign your mortgage agreement, so variable interest rate mortgages may be attractive in the short term.

However, **whether you are better off with a variable interest rate mortgage compared to a fixed interest rate mortgage depends on whether the market interest rates go up or down during your term**. This movement is difficult to predict. For example, between 2000 and 2009, the Bank of Canada Bank Rate, which impacts mortgage rates, varied from 0.5% to 6.0%.

Interest rates from 2000 to 2009



Source: Bank of Canada, Bank Rate

Variable interest rate mortgages: impact of interest rate changes

Before signing a variable interest rate mortgage agreement, it is important to understand how interest rate changes can affect you. There are some differences between variable payments and fixed payments, as shown in the chart below.

Payment type	If interest rates go up	If interest rates go down
Variable payments	• your payments amount would go up • you may have higher payments than if you had chosen a fixed interest rate mortgage. **Consider how much of an increase in mortgage payment you could handle.** If you don't think you can handle an increase in your mortgage payment due to rising interest rates, or do not have enough cash flow, you may be better off with a fixed interest rate mortgage.	• your payment amount may go down. Check with your lender to see if you can pay down your mortgage faster by maintaining or increasing your payments, or making a lump sum prepayment.
Fixed payments	• you would pay less toward your principal than expected and more toward interest, **which would lengthen the time needed to pay off the mortgage**. • At the end of the term, the mortgage lender may require you to increase your payments so that your mortgage will be paid off within the amortization period that you originally agreed to • you may pay more in interest than if you had chosen a fixed interest rate mortgage.	• you would pay more toward your principal than expected and less towards interest, **which would shorten the time needed to pay off your mortgage** • you would pay less in interest with a variable rate mortgage than with a fixed interest rate mortgage.

Variable interest rate: how to protect yourself

Some lenders offer **interest rate caps** or **convertibility features** on their mortgages. These features can offer some protection if interest rates go up. You can get these features **only** when you sign a new mortgage agreement.

An **interest rate cap** is the maximum interest rate that can be charged on a mortgage, regardless of the rise in interest rates.

If your mortgage has a **convertibility feature**, you can "convert" or change it to a fixed interest rate mortgage during the term. Although the lender will usually not charge a penalty for the mortgage conversion, certain conditions apply – check with the lender.

Remember

The fixed interest rate could be higher when you convert the mortgage than the variable interest rate you had been paying.

EXAMPLE:

Samantha is buying a new home and requires a $200,000 mortgage. She is trying to decide between a fixed rate and a variable rate mortgage.

- Samantha has chosen a 25-year amortization period, with the goal of being mortgage-free as soon as possible.
- She decides to get a five-year term.
- The lowest fixed interest rate she is offered is 4%, with a monthly payment of $1,052.
- The current variable rate she can get is 3%, with a monthly payment initially set at $946.

For the variable rate option, the lender explains to Samantha that her payments could go up and down with the interest rates. If Samantha decides to go with a variable interest rate, **she will need to budget for the possibility that her mortgage payments may increase**.

To help her decide if getting a variable interest rate is right for her, she looked at the following scenarios.

Variable interest rate

	Scenario 1: interest rate increases by 2% during 5-year term		Scenario 2: interest rate increases by 4% during 5-year term	
	Interest rate	**Monthly payment**	**Interest rate**	**Monthly payment**
Year 1:	3.0%	$946	3.0%	$946
Year 2:	3.5%	$997	4.0%	$1,048
Year 3:	4.0%	$1,046	5.0%	$1,152
Year 4:	4.5%	$1,096	6.0%	$1,256
Year 5:	5.0%	$1,144	7.0%	$1,361
Over 5-year term				
Total payment		**$62,750**		**$69,154**
Total interest paid		$36,834		$46,001
Outstanding balance after 5 years				
		$174,084		$176,847

Over the life of the 5-year term:

- for scenario 1, Samantha's monthly payments would increase by $198 (from $946 to $1,144)
- for scenario 2, her monthly payments would increase by $415 (from $946 to $1,361).

Scenario 3: fixed interest rate option at 4%

- Samantha's monthly payments would be $1,052.
- Her total payments during the 5-year term would be $63,122.
- She would pay $37,230 in interest during that period.
- Her outstanding balance after 5 years would be $174,108.

Samantha will have to consider if she is comfortable with the possibility of interest rates increasing and if her budget could handle higher payments. If not, a fixed rate mortgage term may be in her best interest.

Making a decision between fixed and variable interest rate mortgages

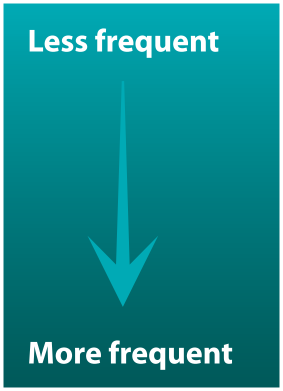
There are a few factors to consider when choosing between a fixed and variable interest rate mortgage:

A fixed interest rate mortgage may be better for you if:	A variable interest rate mortgage may be better for you if:
• you want to know your interest rate or the amount of your regular payments is not going to change over the term of your mortgage • you prefer knowing in advance how much of your mortgage will be paid off at the end of your term • you think there is a good chance that market interest rates will rise over the term of your mortgage.	• you can handle an increase in your mortgage payment if interest rates increase • you are comfortable with the possibility that – your mortgage interest rate and payments could increase – you could pay more in interest over the term of your mortgage than you would have paid with a fixed interest rate • you follow interest rates closely • you think there is a good chance of interest rates staying the same or dropping over the term.

FREQUENCY OF PAYMENTS

Options

Most financial institutions offer a number of payment frequency options:



monthly

semi-monthly

biweekly

accelerated biweekly

weekly, and

accelerated weekly.

Accelerated payment options

Accelerated weekly and accelerated biweekly payments can save you thousands, or even tens of thousands in interest charges, because you'll pay off your mortgage much faster using those options.

The reason is that you make the equivalent of **one extra monthly payment per year**.

Standard payment options

The standard payment options are

- monthly
- semi-monthly
- biweekly
- weekly.

For these four payment options, there is no difference in the total amount you will pay over a year. This means that there is very little extra saving if you switch from a monthly payment option to one of the other standard payment options.

Payment options details

Payment frequency	Description
Monthly	One payment per month for a total of 12 for the year.
Semi-monthly **(twice a month)**	Two payments per month for a total of 24 for the year. With this option, the total amount you pay over the year is the same as with the monthly payment (monthly payment ÷ 2).
Biweekly **(every two weeks)**	A payment every two weeks. Since there are 52 weeks in a year, the total number of payments over the year is 26 (52 ÷ 2). This option keeps the total payment over the year the same as with the monthly payment (monthly payment x 12 months ÷ 26).
Accelerated biweekly	A payment of half the monthly payment every two weeks. Since there are 52 weeks in a year, you will make 26 payments a year (52 ÷ 2). To calculate the amount of your accelerated biweekly payments, divide your monthly payment by two (for example, \$1,000 ÷ 2 = \$500). **With this payment frequency, you will make the equivalent of one extra monthly payment per year. You will pay off your mortgage faster and save in interest charges.**
Weekly	One payment per week for a total of 52 payments for the year. The total annual payment remains the same as with the monthly payment (monthly payment x 12 months ÷ 52).
Accelerated weekly	A payment of one quarter of the monthly payment every week. To calculate the amount of your accelerated weekly payments, divide your monthly payment by four (for example, \$1,000 ÷ 4 = \$250). **With this payment frequency, you will make the equivalent of one extra monthly payment per year. You will pay off your mortgage faster and save in interest charges.**

EXAMPLE: MONTHLY VS. ACCELERATED BIWEEKLY

John is trying to decide between paying his mortgage monthly and paying accelerated biweekly.

Details

- mortgage principal: $150,000
- amortization: 25 years
- interest rate: 5.45% for the entire mortgage amortization period

Monthly and Accelerated Biweekly Payment Comparison

	Monthly	Accelerated biweekly
Number of payments per year	12	26 (52 weeks a year ÷ 2)
Payment	$911	$456
Total payments per year (principal and interest)	$10,932	$11,856
Principal paid over the amortization period	$150,000	$150,000
Interest paid over the amortization period	$123,368	$102,113
Interest saved	**–**	**$21,255**
Number of years to repay the mortgage	**25.0**	**21.3**
Years saved	**–**	**3.7**

With the accelerated biweekly payments, John will pay off his mortgage 3.7 years faster and save more than $21,000 in interest.

Mortgage calculator tool

See our **mortgage calculator tool** on FCAC's website at **www.fcac.gc.ca** to find out how these payment options will affect the length of time it takes you to pay off a mortgage loan and how much interest you could save.

MORTGAGE DEFAULT INSURANCE

Mortgage default insurance (sometimes called mortgage loan insurance) protects the mortgage lender in case you are not able to make your mortgage payments. It does not protect you.

You must pay mortgage default insurance if your down payment is **less than 20%** of the purchase price of your home. This is called a high-ratio mortgage.

The maximum amortization period is 25 years for mortgages with mortgage default insurance.

Mortgage default insurance is only available for high-ratio mortgages if the purchase price of the home is less than $1 million.

If you can put **at least 20%** of the purchase price of your home as a down payment, you will have what is called a conventional mortgage. In this case, mortgage default insurance is generally not required. There are exceptions to this, for example in the situations where your salary is not paid on a regular basis.

EXAMPLE:

Let's say Paula is considering buying a $200,000 home, and she can put $35,000 as a down payment. Paula's down payment is 17.5% of the purchase price of the home.

$35,000 ÷ $200,000 x 100 = 17.5%

Because Paula's down payment is less than 20% of the purchase price, she will need to pay mortgage default insurance.

Who offers mortgage default insurance?

Mortgage default insurance is provided by insurers such as

- Canada Mortgage and Housing Corporation (CMHC)
- Genworth Financial
- Canada Guaranty Mortgage Insurance Company.

Your lender will make the arrangements for your mortgage default insurance if you need it.

How much are the premiums?

The premium – that is, the cost of mortgage default insurance – will vary depending on the percentage you have as a down payment: the bigger your down payment, the lower your mortgage default insurance premium. Usually, mortgage default insurance premiums vary from 0.5% to 3% of the borrowed amount.

If you get an amortization period that is longer than 25 years, the premium will be higher.

EXAMPLE: MORTGAGE DEFAULT INSURANCE PREMIUMS

Paula's down payment of $35,000 is 17.5% of the $200,000 purchase price of the home. Because her down payment is less than 20%, she will need to get mortgage default insurance.

Lets assume that

- the premium is added to the mortgage of $165,000
- the insurance premium rate is 2%
- the mortgage will be amortized over 25 years
- the interest rate is 5%.

The mortgage default insurance premium will cost $165,000 x 2%
= $3,300

The total mortgage loan would then be $165,000 + $3,300
= $168,300

In the above example, this mortgage default insurance would cost Paula $3,300 and would be added to the mortgage total. The monthly payment would increase from $960 to $979. Over the amortization period, the mortgage default insurance would cost her an additional $2,458 in interest.

OTHER INSURANCE OPTIONS

Mortgage life insurance

Mortgage life insurance pays the remaining balance on your mortgage to the lender in the event of your death. This can be useful if you have dependants or a spouse who might like to stay in the home after your death – but who might not be able to continue making the same mortgage payments as before. Remember that your home can be sold to pay back the mortgage, so mortgage life insurance may not be necessary for you.

Mortgage disability insurance

Mortgage disability insurance will make mortgage payments to your lender if you cannot work due to a severe injury or illness. Most disability insurance plans have a number of conditions attached to them, including a specific list of illnesses or injuries that are covered or excluded. **Pre-existing medical conditions are usually not covered.** These terms and conditions of insurance are usually listed in the insurance certificate, so ask to see it before you apply so that you understand exactly what the insurance covers.

Cost of insurance

The cost of mortgage life or disability insurance, called the premium, depends on your mortgage amount and your age.

Where can you get these products?

You can buy mortgage life and disability insurance through your mortgage lender, or through another insurer or financial institution. It is a good idea to shop around to make sure you are getting the best insurance to meet your needs.

MORTGAGE OPTION: CASH BACK

Cash back is an optional feature that pays you a percentage of your mortgage in cash right away, in some cases **in return for a higher interest rate than you would have paid without that feature**. This can help you pay for things you'll need when getting a new home, such as legal fees or even furniture.

Restrictions

The lender can impose certain restrictions on the cash back. For example, **you may be asked to repay some or all of the cash back amount if you decide to refinance, transfer or renew your mortgage before the end of the term**. Shop around and ask for all the conditions before applying for cash back on a mortgage.

STEP 2: SHOP AROUND AND GET PRE-APPROVED

The second step in shopping around for a mortgage is getting pre-approved. This step allows you to find out how much a mortgage lender is willing to lend you and at what interest rate.

BEFORE YOU START SHOPPING AROUND FOR A MORTGAGE

Verify that your credit report is in order

Before you start shopping around for a mortgage, you should order a copy of your credit report to make sure it does not contain any errors. A credit report is a snapshot of your financial history at a specific point in time. It shows your previous and current debts, and whether or not you've had any problems in the past paying off those debts.

A potential lender will look at a copy of your report before approving you for a mortgage loan, so it is important that your report be accurate. You can order a copy of your credit report for free by mail or by telephone through the two major credit reporting agencies in Canada: Equifax (www.equifax.ca) and TransUnion (www.transunion.ca).

A lender will also want to check your credit score, which is a number that represents your financial health at a specific point in time and shows your likeliness to pay off future debts. **The score is based on the information in your credit report.** The lender may use the credit score provided by the credit reporting agency, or may use the information in your credit report to calculate your score, according to the lender's own formula.

If you do not have a good credit score, the mortgage lender could refuse to approve your mortgage, or may decide to approve it for a lower amount, and/or a higher interest rate. Some lenders may only consider your application if you have a large down payment, or if you have someone co-signing with you on the mortgage.

For more information

For more information about how to obtain a copy of your credit report, what it contains and how to correct errors in your report, consult FCAC's publication *Understanding Your Credit Report and Credit Score*.

UNDERSTANDING THE PRE-APPROVAL PROCESS

A pre-approval is a preliminary discussion with a potential mortgage lender to find out how much you can afford to borrow and at what interest rate. With a pre-approval, you can do the following:

- lock in an interest rate in case interest rates rise before you purchase a home (the length of the interest rate guarantee varies by financial institution)

  If interest rates fall before you purchase a home, you **may or may not get the lowest rate**.

- estimate your mortgage payment, so that you can include it in your budget
- know the amount of a mortgage that you qualify for, so that you don't waste time looking for a home that you cannot afford.

A pre-approval does not necessarily guarantee that you will get the mortgage loan. Once you have a specific home in mind, the lender will want to verify that the home or property meets certain standards (such as the condition or market value of the home) before approving your loan. At that point, the lender could decide to refuse your mortgage application, even though a pre-approval for a certain amount was made.

Keep in mind that the pre-approved amount is the maximum you could receive. It may be a good idea to look at homes in a lower price range so that your budget will not be stretched to the limit.

Where can you go to get pre-approved?

You can get pre-approved by mortgage lenders or mortgage brokers.

Mortgage lenders

Mortgages are available from several types of lenders, such as

- banks
- mortgage companies
- insurance companies
- trust companies
- loan companies
- credit unions, and
- caisses populaires.

Different lenders may have different interest rates and conditions for similar products, so you should talk to several lenders to make sure you're getting the best product for your needs. You'll also get a feel for the lender and you'll be able to determine who you would rather have the long-term relationship with. Although you can decide to switch lenders at the end of each term, it is important to be comfortable with the lender and the mortgage options offered to you right from the start.

Mortgage brokers

Another option is to talk to mortgage brokers. Rather than lending money directly to you, brokers arrange transactions by finding a lender for you. Since brokers have access to a number of lenders, they may give you a wider range of loan products and terms to choose from.

However, mortgage brokers do not all have access to the same lenders, so the available mortgages vary from broker to broker. Shop around with more than one broker, just as you should with banks and other financial institutions. Compare not only interest rates, but also other features of the mortgages such as prepayment options.

To get a list of mortgage brokers in your area, visit the website of the Canadian Association of Accredited Mortgage Professionals at www.caamp.org, or call them toll-free at 1-888-442-4625.

What you should bring to a pre-approval interview

When you are speaking to a potential mortgage broker or lender, it is a good idea to have the following information handy:

- identification
- proof of employment
  - proof of current salary
  - position and length of time with the organization
- proof of down payment
  - recent financial statements (bank accounts, investments)
- your current debt or financial obligations
  - credit card balances and limits, including those on store credit cards
  - child support or alimony amounts
  - car loans or leases
  - lines of credit
  - other loans.

Questions to ask

- Do you automatically get the lowest rate if interest rates go down while you are pre-approved?
- How long is the pre-approved rate guaranteed?
- Can the pre-approval be extended?

QUALIFYING FOR A MORTGAGE

How much can you qualify for?

Mortgage lenders or brokers will use your financial information to determine how much they can lend you, given your income and current debts. They will use two financial formulas to help them:

- the gross debt service (GDS) ratio, and
- the total debt service (TDS) ratio.

CMHC has guidelines of 32% of your gross income for the GDS ratio and 40% for the TDS ratio. The mortgage lenders will use these ratios to determine the maximum amount they can lend you.

What is the GDS ratio?

Gross debt service (GDS): the percentage of your gross income (before deductions such as income tax) required to cover the costs associated with your home, such as mortgage payments, property taxes and heating. As a general rule of thumb, the GDS ratio should not exceed 32% of your gross income.

What is the TDS ratio?

Total debt service ratio (TDS): the percentage of gross income (before deductions such as income tax) required to cover the costs associated with your home, such as mortgage payments, property taxes and heating, plus other debts, such as credit card payments, car payments or lines of credit. As a general rule of thumb, the TDS ratio should not exceed 40% of the home owner's gross income.

Calculating your GDS and TDS ratios

If you have less than a 20% down payment and are applying for a variable rate mortgage or a mortgage with a fixed term of less than five years, federally regulated financial institutions will use the five-year fixed interest rate for mortgages to assess whether you qualify for a mortgage, even if you are planning on getting a shorter term with a lower interest rate.

To calculate your GDS and TDS ratios, use FCAC's online calculator, called t*he Mortgage Qualifier Tool*, at **www.fcac.gc.ca**.

Or, you can estimate the maximum costs you can afford, given your income and current debts.

If you are buying the home with a partner, or someone else, combine your incomes to accurately reflect the household income.

1. Calculate your monthly gross income

Gross income is your income before income taxes and other deductions.

$$\text{Monthly gross income} = \frac{\text{annual gross income}}{\text{12 months}}$$

EXAMPLE

Let's say your income is $54,000 a year, before income taxes and other deductions. Using the formula above, your monthly gross income is therefore:

$$\text{Monthly gross income} = \frac{\$54{,}000}{\text{12 months}} = \$4{,}500.00$$

2. Calculate the maximum amounts you can spend on home costs

Maximum GDS home costs = monthly gross income x **32%**
Maximum TDS home costs = monthly gross income x **40%**

EXAMPLE

With a gross monthly income of $4,500.00, here are the maximum amounts you can afford to spend per month on home costs.

Maximum GDS home costs = $4,500.00 x **32%** = $1,440.00

$1,440.00 represents the **maximum** amount you can spend on mortgage payments, property taxes, heating and condo fees (if applicable).

Maximum TDS home costs = $4,500.00 x **40%** = $1,800.00

$1,800.00 represents the **maximum** amount you can spend on mortgage payments, property taxes, heating, condo fees (if applicable), but also credit card payments, car payments, alimony and other loan payments.

It is important to understand that maximum amounts you calculate may actually overestimate what you can actually afford. This is because the GDS and TDS ratios do not take into account the extra costs associated with buying a home – for example, unexpected expenses such as major home repairs.

3. Compare the results with the estimated costs for your new home

To do this, you'll need to estimate what the costs will be for your new home, including all the ones described in the GDS and TDS ratios. If the total costs you estimate are lower than the maximum amounts you calculated, you will probably qualify for a mortgage loan with the lender.

STEP 3: MAKE THE RIGHT DECISION FOR YOUR NEEDS

The third step in shopping around for a mortgage may be the most important: making your final decision. Before you make that decision, you will need to

- consider the other costs to “close” your agreement to buy the home
- know what your rights and responsibilities are and what your lender must provide in the mortgage agreement.

Read on for more information on these points.

OTHER COSTS TO CONSIDER

Closing costs

Closing costs are up-front costs that you must pay when you purchase a home, usually before you move in. Your lawyer can help explain these costs. They may include, but are not limited to:

- appraisal fee
- legal fees
- title insurance
- land registration fees (sometimes called a land transfer tax, deed registration fee, tariff or property purchase tax)
- prepaid property taxes and/or utility bills (to reimburse the vendor for prepaid costs)
- survey or Certificate of Location cost
- water tests
- septic tank tests (if applicable).

For more information on closing costs, visit the Canada Mortgage and Housing Corporation's website at www.cmhc.gc.ca, or call them toll-free at 1-800-668-2642.

Other up-front costs

Other up-front costs that you may have before moving in are:

- moving costs
- storage costs
- real estate costs for selling your home (if applicable)
- redirecting mail.

Costs you may have shortly after moving in can include:

- utility hook-up fees
- basic furniture and appliances
- painting and cleaning.

Ongoing cost related to owning a home

Ongoing costs related to owning and maintaining a home will probably be the largest part of your monthly budget once you've settled in. These can include:

- mortgage payments
- property taxes
- utilities
- property insurance
- renovation costs
- landscaping and maintenance
- repairs.

Planning ahead

For a list of costs that can apply before you buy and after you've moved in, see the Monthly Housing Expenses Worksheet on page 40.

Plan for these expenses by including them in your budget. For more information on making a budget, see FCAC's publication *Making a Budget and Sticking to It*.

YOUR RIGHTS AND RESPONSIBILITIES

Your rights

Federally regulated financial institutions (such as all banks, as well as some insurance companies and trust and loan companies) must provide you with certain important information about your mortgage, in clear language, in their mortgage application and in your mortgage agreement. Depending on what type of mortgage you get, the information required can vary. The most important information will be summarized in a box like the examples below and on page 34.

Your responsibilities

Before signing, you have a responsibility to read and understand the terms and conditions of your mortgage agreement. Ask questions about anything that is not clear.

Information box: Fixed interest rate mortgage

This is a sample of the information box that must be at the beginning of a fixed interest mortgage agreement.

Principal Amount	**$255,450.00**
Annual Interest Rate	**5.50%** Fixed rate per year. This interest is compounded twice per year but charged monthly.
Annual Percentage Rate	**5.50%** The interest rate for a whole year (annualized) including applicable fees such as service charge, loan origination fees or administrative fees when applicable.
Term	**5 years** The term of the loan is closed for the whole five years, which means that you cannot pay down more than your prepayment privilege without paying a penalty.
Date of Advance	**July 28th, 2010** This is the date your funds will be advanced. Interest will be calculated and charged from this date on.

Payments	**$1,948.28 on the 28th of every month** Your payment is payable monthly and includes payment toward the principal amount, the accumulated interest and your monthly property tax portion.
Amortization Period	**20 years** Based on the current terms and conditions, your mortgage will take 20 years to pay in full.
Prepayment Privilege	**"10+10"** Without paying a penalty, you may once per year: • increase your monthly payment by 10% of the original payment • pay a lump sum of 10% of the original mortgage amount toward your outstanding balance.
Prepayment Charges	You will be charged a penalty if you pay more of your mortgage than the prepayment privilege allows. If you want to pay out all or part of your mortgage before the end of your term, you will also pay a penalty. Your penalty will be the greater of: • three months interest, or • the interest rate differential: the difference between your mortgage rate and the rate of a mortgage that is closest to the remainder of your term, multiplied by the outstanding balance of your mortgage for the time that is left on your term. It is calculated on the amount being prepaid.
Default Insurance	**$5,450.00** (included in your principal amount) Insurance premium$5,000.00 Tax (9%) $450.00 Total $5,450.00
Other Fees	Discharge fee: **$200.00** Default charge: **$50.00** Returned or refused payment due to insufficient funds: **$40.00**

Additional information for fixed interest rate mortgages

Other information must be provided when you sign a fixed rate mortgage agreement. The mortgage lender must provide you with the following information:

- the total amount that you will have paid at the end of the term
- of that total, how much you will have paid in interest charges at the end of the term
- the fact that your payments will be applied first to cover interest and other charges, and then to the outstanding principal
- the optional services (such as disability or life insurance) you accepted, how much they cost, and what will happen, in terms of rebates, charges and penalties, if you decide to cancel these services
- a description of the property (if any) being provided as a security for the loan
- whether any fees paid by the financial institution to a broker were included in the amount lent to you.

Information box: Variable interest rate mortgage

Below is a sample of the information box that must be at the beginning of a variable interest mortgage agreement.

Principal Amount	**$255,450.00**
Annual Interest Rate	**3.25%** Variable rate per year. This interest is compounded twice per year but charged monthly.
Determination of Interest	Your interest rate is expressed as today's (name of bank) prime rate* plus an adjustment factor. Your interest rate is the prime rate + 1.00% As of June 15 2010, the prime rate is 2.25% Your interest rate will vary automatically if and when the (name of bank's) prime rate varies. *The prime rate means the variable annual interest rate that (name of bank) publishes from time to time as a point of reference.
Annual Percentage Rate	**3.25%** The interest rate for a whole year (annualized), including applicable fees such as service charges, loan origination fees or administrative fees when applicable.

Term	**5 years** The term of the loan is closed for the whole five years, which means that you cannot pay down more than your prepayment privilege without paying a penalty.
Date of Advance	**July 28th, 2010** This is the date your funds will be advanced. Interest will be calculated and charged from this date on.
Payments	**$1,648.91 on the 28th of every month** Your payment is payable monthly and includes payment toward the principal amount, the accumulated interest and your monthly property tax portion.
Amortization Period	**20 years** Based on the current terms and conditions, your mortgage will take 20 years to pay in full.
Prepayment Privilege	**"10+10"** Without paying a penalty, you may once per year: • increase your monthly payment by 10% of the original payment • pay a lump sum of 10% of the original mortgage amount toward your outstanding balance.
Prepayment Charges	You will pay a penalty if you pay more of your mortgage than the prepayment privilege allows. If you want to pay out all or part of your mortgage before the end of your term, you will also pay a penalty. Your penalty will be the greater of: • three months interest, or • the interest rate differential: the difference between your mortgage rate and the rate of a mortgage that is closest to the remainder of your term, multiplied by the outstanding balance of your mortgage for the time that is left on your term. It is calculated on the amount being prepaid.
Default Insurance	**$5,450.00** (included in your principal amount) Insurance premium $5,000.00 Tax (9%) $450.00 Total $5,450.00
Other Fees	Discharge fee: **$200.00** Default charge: **$50.00** Returned or refused payment due to insufficient funds: **$40.00**

Additional information for variable interest rate mortgages

In addition, when you sign a variable rate mortgage agreement, the lender must provide you with the following information:

- based on that interest rate, an estimate of the total amount you will pay by the end of your term;
- an estimate of the total amount of interest you will pay during the term;
- if interest rate variations are linked to another rate, such as the prime rate, the financial institution must provide you, **at least once a year**, with a disclosure statement containing the following information:
  - the interest rate and outstanding balance at the beginning and end of the period covered by the statement; and
  - the amount of each instalment payment for the upcoming period, based on a forecast using the interest rate in effect as of the date of the disclosure statement.

For variable rate mortgages with fixed payments, the lender must also include the following details in the agreement or disclosure document:

- the annual interest rate that would result in your mortgage payment not covering the interest due for the period (sometimes called the "trigger rate"), and
- the fact that if the interest rate increases during your term, your amortization period will be longer.

Notes:

- If the interest rate reaches the "trigger rate", your lender may require you to increase your payments. Check the terms of your agreement.
- If your amortization period has become longer, your mortgage lender may require you to increase your payments at the next renewal period to get your amortization back in line with the original amortization period.

Coercive tied selling

Coercive tied selling happens when a mortgage lender pressures or forces you to buy another of its products as a condition for approving your mortgage loan. **For federally regulated financial institutions (such as banks), this is against the law.** For example, the lender may not require you to purchase mutual funds through them to get a mortgage.

If this happens to you, contact FCAC so that FCAC can investigate your complaint.

What is **not** coercive tied selling

The following situations are not considered coercive tied selling:

- when a lender offers you other products and services (for example, home insurance, life or disability insurance, or a line of credit) in addition to your mortgage but not as a condition for getting it;
- when a lender offers you better conditions on your mortgage if you take mortgage life insurance through them, instead of through another insurer, or if you transfer your investment portfolio to them. Although such offers may seem interesting, it is a good idea to get quotations from other providers of these services and products to make sure you get the best deal.

Dealing with mortgage brokers

Mortgage brokers are provincially regulated. For a list of provincial regulators, visit the FCAC website at **www.fcac.gc.ca**.

SUMMARY OF THE THREE STEPS TO SUCCESSFUL MORTGAGE SHOPPING

Step 1

Know what you need and want in a mortgage

Before you start shopping around for a home or a mortgage, understand the following:

- the minimum down payment required to buy a home
- the down payment amount that you will need to avoid having to pay for mortgage default insurance
- how the Home Buyers' Plan (HBP) can help you make the down payment on your home
- the difference between term and amortization period
- how accelerated payment options can help you save money in interest and shorten the time it will take you to pay off your mortgage
- the difference between fixed and variable interest rate mortgages
- the difference between open and closed mortgages
- the prepayment options you might like to have on a mortgage
- optional insurances available on mortgages, such as:
  - life insurance
  - disability insurance.

Step 2

Shop around and get pre-approved

Before shopping around:

- Evaluate your financial situation to determine how much you can afford as a down payment and as regular mortgage payments.
- Request a copy of your credit report to make sure it does not contain any errors. Lenders can check this information.

Key tips while you are mortgage shopping:

- Shop around at a few different lenders and brokers to obtain pre-approvals for a mortgage before you start looking for a home. **Keep in mind that the pre-approved amounts can overestimate what you can actually afford to pay.**
- Bring all the information that you may need during the pre-approval interview with a lender.
- Consider only homes that you know you can afford based on pre-approvals you received from different lenders.
- Know how much you can afford to borrow by calculating the maximum home costs based on your income and current debts. Use the GDS and TDS formulas. Remember to add to your budget any additional costs you expect in the near future, such as starting a family or purchasing a car.
- Don’t accept the first offer made to you. Make sure you have explored other offers to find one that best meets your needs.
- Be sure that the pre-approval contains the terms that you want – for example, the prepayment options that you want to be able to use.
- Don’t underestimate a small difference in interest rates between offers. A small difference may have a major impact on the interest you pay in the long run.

Step 3

Make the right decision for your needs

Before signing a mortgage agreement:

- Budget realistically for the extra costs that you must pay when you buy a home, including closing costs, moving costs and other costs related to owning and maintaining a home.
- Read the terms and conditions of your mortgage agreement carefully. Ask questions about anything you don’t understand.
- Don’t forget that federally regulated financial institutions (such as banks) cannot use coercive tied selling to force you to get another product.

MONTHLY HOUSING EXPENSES WORKSHEET

One-time expenses		Estimated amount
Before moving in		
Down payment		
Legal fees		
Deposits to builders *(if applicable)*		
Real estate fees *(if applicable)*		
Closing costs		
Land transfer taxes *(if applicable)*		
Home inspection		
Up front mortgage costs – e.g. appraisal fees, default insurance premiums *(if not included in mortgage payments)*		
Other expenses:		
Shortly after moving in		
Hook-up costs *(cable, satellite, phone, Internet)*		
Basic furniture/appliances/window coverings		
Other expenses:		
TOTAL one-time costs		
Subtract amount of money already saved	-	
Balance to be saved		
Divide by the number of months before your home purchase	÷	
Monthly savings target for budget	=	

Ongoing expenses	Estimated monthly amount
Regular expenses	
Mortgage payments	
Mortgage loan (default) insurance *(if required and not included in mortgage payments)*	
Optional – mortgage life/disability insurance *(if not included in mortgage payments)*	
Home/property insurance	
Utilities: – Heat/electricity	
– Water/sewer	
Telephone/Internet	
Cable/satellite	
Property taxes *(if not included in mortgage payments)*	
School taxes *(if paid separately from your property taxes)*	
Condominium fees *(if applicable)*	
Cleaning supplies/service	
Repairs/maintenance – (e.g. roof repairs, painting, plumbing etc…); *as a general guide - budget one to three percent annually of the value of the home, then divide by 12.*	
Other day-to-day expenses:	
Occasional expenses *(divide yearly costs by 12 for a monthly number)*	
Landscaping/lawn service	
Snow removal service	
Additional furniture and appliances	
Other occasional expenses:	
Monthly ongoing expenses *(use this total and enter it into your monthly budget)*	

ABOUT THE *ABCs OF MORTGAGES* SERIES

The *ABCs of Mortgages* series explains the features and costs of mortgages. The following resources are part of the series and are available on FCAC's website at **www.fcac.gc.ca**:

Publications

- Buying Your First Home
- Paying Off Your Mortgage Faster
- Renewing and Renegotiating Your Mortgage
- Borrowing on Home Equity

Tip sheets

- Shopping Around for a Mortgage
- Buying and Maintaining a Home: Planning Your Housing Budget
- Choosing an Amortization Period: What is the Impact on Your Mortgage
- Understanding Variable Interest Rate Mortgages
- Understanding Reverse Mortgages
- Protect Yourself from Real Estate Fraud

Online tools

- Mortgage Qualifier Tool
- Mortgage Calculator Tool

Online Quiz

- Mortgage Quiz

GLOSSARY

Amortization period

The period of time it will take to pay off a mortgage in full. The most common amortization period for a new mortgage is 25 years. Not to be confused with the **term** of the mortgage.

Cash back

An optional feature that pays you a percentage of your mortgage in cash right away, in some cases in return for a higher interest rate than you would have paid without that feature. This can help you pay for things you'll need when getting a new home, such as legal fees or even furniture.

Credit report

A snapshot of your credit history and one of the main tools lenders use to decide whether or not to give you credit. You can request a copy of your credit report from the two credit-reporting agencies, Equifax and TransUnion.

Credit score

A numeric rating that is a reflection of your financial health, at a specific point in time. It indicates the risk you represent for lenders, compared with other consumers. The credit-reporting agencies, Equifax and TransUnion, use a scale from 300 to 900. Lenders may also have their own ways of arriving at credit scores. Credit score is sometimes also called credit rate.

Closed mortgage

A mortgage agreement that cannot be prepaid or changed before the end of the term. Your lender may let you make certain prepayments without penalty, but you will usually have to pay a penalty to break your mortgage agreement.

Closing costs

Costs in addition to the purchase price of the home, such as appraisal fees, legal fees or prepaid property taxes. These costs must be paid before you take possession of your home. They range from 1.5% to 4% of a home's selling price.

Coercive tied selling

An illegal practice where a lender pressures or forces you to buy another of their products as a condition for giving you the mortgage loan. This is against federal law. However, your lender can offer you, in conjunction with one of their products, another product or service on more favourable terms than they normally would provide – for example, a lower mortgage rate if you have investments with the same financial institution.

Conventional mortgage
A mortgage loan of up to a maximum of 80% of the purchase price of a home. You must get mortgage default insurance if your mortgage exceeds that limit.

Down payment
The amount of money you deposit when you first buy your home. It must be at least 5% of the purchase price, but can be more. The down payment will help determine how much you need as a mortgage loan, and whether or not you will have to pay mortgage default insurance, which is required if you have a down payment of less than 20% of the purchase price.

Gross debt service (GDS) ratio
The percentage of your gross income (before deductions such as income tax) required to cover the costs associated with your home, such as mortgage payments, property taxes and heating. As a general rule of thumb, the GDS ratio should not exceed 32% of your gross income.

Fixed interest rate mortgage
A mortgage loan where the interest rate and payment amount do not change for a specific term.

High ratio mortgage
A mortgage for more than 80% of the purchase price of the home. For a high ratio mortgage, mortgage default insurance is required.

Interest
The amount paid by a borrower to a lender for the use of the money.

Mortgage
A loan (usually for buying a property) in which the lender can take possession of the property if the loan is not repaid on time. Payments include the principal and the interest; they may also include a portion of the property taxes.

Mortgage broker
A person or organization that offers the mortgage products of different lenders.

Mortgage default insurance
Insurance that protects the mortgage lender if you cannot make your mortgage payments. It is required by law if your down payment is less than 20%. This should not be confused with mortgage life insurance or home, property, fire and casualty insurance, which typically protect the home owner.

Open mortgage
A mortgage that can be prepaid at any time during the term, without penalty. The interest rate on an open mortgage may be higher than on a closed mortgage with an equivalent term.

Prepayment
Payment of an additional portion or all of the principal balance before the end of your term. Lenders may charge fees when you use a prepayment option under a closed mortgage agreement.

Prepayment penalty
A fee charged to you by the lender for making a prepayment greater than the amount allowed in your mortgage agreement, or for paying off a closed mortgage before the end of the term.

Principal
The amount of money that you borrowed from a lender to pay for your home.

Term
The period of time your mortgage agreement will be in effect. At the end of the term, you either pay off the mortgage in full, renew it or possibly renegotiate your mortgage agreement (for example, decrease your amortization period). Terms are generally for six months to 10 years. Not to be confused with the **amortization period**.

Total debt service (TDS) ratio
The percentage of gross income (before deductions such as income tax) required to cover the costs associated with your home, such as mortgage payments, property taxes and heating, plus other debts, such as credit card payments, car payments or lines of credit. As a general rule of thumb, the TDS ratio should not exceed 40% of the home owner's gross income.

Variable interest rate mortgage
A mortgage with an interest rate that can vary during the term. The interest rate varies in line with changes in the market interest rates. The mortgage payments can be fixed, or they could change with interest rates, depending on the terms of the mortgage.

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