

# Mortgage Basics

Whether you're building a new house or buying an existing one, you will more than likely need financing. A mortgage is a loan for a house that is secured by that property in the event that the loan is not repaid. It is repaid in regular payments that are made up of a portion of the principal (amount borrowed) plus interest (the charge for borrowing money) and can also include a portion of the property taxes. A mortgage can be repaid in regular monthly, biweekly or weekly payments. A more frequent payment schedule (weekly or bi-weekly) can save you money over the long term. More frequent payments in a year will mean less overall interest paid on your mortgage.

It is important that you consult a specialist before starting to shop for a house. He/she will be able to determine if you qualify for a mortgage and approximately how much you can afford. The lender will often do a pre-approval so that you have a price range to help you with your house shopping.

## Types of mortgages

There are many different types of mortgages offered by every financial institution. Here are the basic types:

### Conventional

A conventional mortgage is for an amount which does not exceed 75% of either the value of the property or the purchase price, whichever is lower. To be eligible for this type of mortgage, your down payment must be at least 25% of the purchase price. A conventional mortgage does not require mortgage loan insurance. Having a larger down payment will ultimately decrease your total mortgage payment.

### High-ratio

This is the most common type of mortgage, because it requires only a minimum of 5% down payment. However, unlike a conventional mortgage, it requires mortgage loan insurance. The insurance is offered through Canada Mortgage and Housing Corporation (CMHC) or Genworth Financial. The premium can be added to your mortgage payments or paid in full.

### Closed/Open mortgages:

An open mortgage allows the option of repaying the loan, in part or in full, at any time without penalty. This may be ideal for you if you are expecting to receive additional funds during the course of the mortgage and want to pay down the mortgage before the term ends. It's also a good option if you are planning to sell your home and not bring the mortgage to another home.

Interest rates are usually higher on this type of mortgage. A closed mortgage usually offers the lowest interest rate available and you are locked into the term you agree to.

The interest you pay on your mortgage can either be: fixed or variable. A fixed rate is locked in so that it will not fluctuate during the term. A variable rate will fluctuate. The rate is set based on prime plus or minus a certain %.

### Cash back:

Many financial institutions offer a special option that, as the name suggests, gives you cash in addition to the money you are borrowing for the purchase of the property. This "cash

back" is usually paid as a percentage of the mortgage amount and can be used to pay for moving costs, furniture, or anything you choose.

### Home equity / Blanket Mortgage

Here is a very good way to finance a renovation, purchase another property, or make any other purchase. If you currently own a house, you can use the equity (the difference between the value of the property and the amount left owing) in your home for your borrowing needs. You can use up to 75% of the value of your home to finance your personal borrowing with a Blanket Mortgage. Once set up, you can borrow against your blanket mortgage at any time without ever needing the assistance of a lawyer. If you choose, you can combine a line of credit and/or a personal loan with your mortgage at better rates with access to funds whenever you need them.

### **Mortgage Options**

There are several mortgage features that allow your mortgage to best fit your lifestyle.

- Prepayment: allows you to pay down your mortgage in a lump sum or through extra payments, without penalty.
- Portability: provides the ability to transfer the terms and conditions of your mortgage to your next home.
- Assumability: means as a buyer you may be able to take over the existing mortgage on the property. Should you decide to sell your house, the option to assume your mortgage can also be a selling feature to the buyer.
- Expandability: allows you to increase the principal on a mortgage at the lender's agreed-upon rate of interest.

### **Term vs. Amortization**

A term is a period of time during which mortgage factors, such as interest rates, are set at a particular level. Terms can last from six months to ten years. At the end of the term, you can either pay off the remainder of your mortgage or renew it. Select a shorter term if interest rates are falling and a long term if rates are rising. A term is different from the amortization period. The amortization is the amount of time over which the entire mortgage will be repaid. Most mortgages are amortized over 15, 20 or 25 year periods. If you purchase an energy-efficient home or make energy-saving renovations, you can extend your amortization period from 25 years to a maximum of 35 years. You could also be eligible for a 10% refund on your mortgage loan insurance premium.

Mortgage insurance is an important consideration. There are 4 types of mortgage insurances from which you may select:

- Critical illness insurance
- Life insurance
- Disability insurance
- Loss of employment insurance

### **How much can you afford?**

Some people say you can afford two or even three times your annual income. This is false. You can, however calculate what mortgage payment you can afford. The first affordability rule, the Gross Debt Service (GDS) ratio, is that your monthly housing costs (principal and interest, taxes and heating expenses) shouldn't be more than 32 % of your gross household monthly income. The second affordability rule, Total Debt Service (TDS) ratio, is that your entire monthly debt load shouldn't be more than 40 % of your gross household monthly income. This includes housing costs and other debts such as car loans and credit card payments. Based on these two ratios, lenders will advise you of the maximum home price they think you can afford.

**What information will the lender need from you?**

The lender will need plenty of information from you to determine if you qualify for a mortgage. Your ability to repay the loan is based on your GDS and TDS ratios and also on your assets, liabilities, earnings, employment history and your past record of repaying loans. Before going to see a lender, you should ask him/her what information he/she will need. You will need to supply information such as what debts you have and what your monthly payments are. The lender will also want to know the value of your assets and of what they are composed.

For more information on mortgages, please contact OMISTA Credit Union at any one of our three Moncton branches or visit [www.omista.com](http://www.omista.com).