Mortgages 101:

An Introduction to Mortgages

by

Jay Calafiore

Publisher at

www.mortgageblogger.ca

Mortgage Planner with

Mortgage Architects

FSCO Agent # M08000767 / Brokerage # 10287

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Mortgages 101: An Introduction to Mortgages

A mortgage is one of the key elements along the path to reaching your financial and homeownership goals.

It's also is a powerful financial tool.

A tool that can be used to gain access to investments in your future.

Assets such as your first condo, house or income property.

And when it comes to your future prosperity…

The right mortgage is what works.

So, whether you're looking to finally get the keys to your first place or you're trying to refinance, you'll need the right mortgage to help get you there.

What is a Mortgage?

There are wide range of mortgage options available today. With so many different mortgage products out there, it can be difficult to know which one is right for you.

A mortgage is perhaps the most essential element along the path to homeownership.

Very simply, a mortgage is a loan that you get from a bank or other financial institution that enables you to buy a house or other piece of real estate. It requires a regularly scheduled payment that is often blended to include both principal and interest.

The key difference between a mortgage and a regular loan, is that when you take out a mortgage, you're putting something up for collateral. That something is the home you're buying.

For example, let's pretend you bought your home for $300,000 and you had saved enough money to come up with a 60,000 down payment. This would mean that in order to purchase the house you would have to borrow $240,000.

Your $60,000 down payment goes to the seller and the lender kicks in the remaining $240,000.

Under the mortgage agreement you're the owner of the house with one condition. If you don't make your payments the lender has the right to foreclose the house, evict you, and sell the house to try and recover their part of the loan.

But don't, that's the worst possible scenario right?

The fact that you're here looking for information and doing your homework already put's you further ahead than most and probably means you're serious about becoming a homeowner.

Home Equity

Assuming you make your payments on time, you'll begin to build up equity in your home. Basically, equity is the value of your home that actually belongs to you.

Here's how you calculate it: Take your house's fair market value and subtract how much you owe on the mortgage you took out against it.

If we look at our example above, we can say that you have $60,000 in equity because you have a $240,000 mortgage on a $300,000 home.

But there are two ways of building equity, one is through paying off your mortgage and the other is when your home appreciates in value.

Now that you understand the basics of what a mortgage is, you need to know how a mortgage actually works.

How a Mortgage Works - The Nuts and Bolts

Simply put, a mortgage has four basic components:

- The amount you're borrowing
- The amortization period (the total time you have to pay down your mortgage)
- The term of the mortgage (the amount of time before you have to renew it)
- The cost of your mortgage (the amount of interest being charged by the lender)

The length of time your mortgage is amortized determines the size of your mortgage payment.

Tip: Making mortgage payments bi-weekly rather than monthly allows you to make more payments per year thereby paying down your mortgage faster.

A common amortization period is 25-30 years as payments are more affordable than a mortgage with a shorter amortization. The maximum amortization period in Canada is 35 years.

Mortgage terms typically range from 1-5 years however it's possible now to get longer terms.

The amount of interest that's charged by the lender (or the interest rate), is determined by the market and the current state of the economy, in conjunction with your own financial situation and credit record. Whether or not you plan to make the home your primary residence also affects the interest rate.

Principal vs Interest

When you apply for your mortgage, your mortgage broker will help prepare your amortization schedule. This is a monthly or bi-weekly payment timetable that will show you how each payment will be allocated towards the different components of your debt.

For each mortgage payment, some funds will be allocated to cover the interest charges and the rest will go towards paying down the principal - the amount you actually borrowed.

With a new mortgage, less of the payment goes towards the principal with most of it paying interest charges. However, as time passes, this relationship shifts and as less interest gets paid and more goes towards the principal until you pay very ittle interest at all.

Generally speaking the faster you pay off your mortgage the less interest you will have to pay in the long run. In addition, your mortgage is a great place to allocate (invest) any extra cash you may come into.

Some lenders charge "prepayment penalties" when you try and pay your mortgage off early. Try to avoid these types of mortgages where possible.

Mortgage flexibility is important and something that shouldn't be overlooked.

Which Types of Mortgages Are Available? (And Which One is Right For You)

No matter what kind of market exists, it has never been easier to buy a home.

By far the greatest benefits to all the mortgage options available today are flexibility and accessibility. Previously, you had a save a 25% down payment and were limited to strict amortization options.

That's not the case anymore.

This is why shopping for a mortgage can be an exciting step on the path to homeownership.   A vast array of creative **and safe** mortgage products are being offered by the lending industry making the dream of homeownership much easier and more real.

Not only has it never been easier to buy a home, it's never been easier to buy more home.

Longer amortization periods and simply being able to borrow more money are why this is now possible.

Of course with more options your decision can be more complicated. Certain mortgage products will be a better fit for you than others.

Choosing the right mortgage really comes down to criteria like whether you have a down payment or not, whether you like taking risks or are more conservative, and whether you have steady income or are self employed.

But if you keep these criteria in mind, it becomes much easier to make informed decisions, especially if you know a little bit about the different mortgage options available to you.

An Easy Guide to Fixed Rate Mortgages

When you think of something that is fixed, you think of something that is consistent, unchanging, and secure.

And a fixed rate mortgage is exactly those things.

This is the main reason it appeals to so many people, despite the fact that overtime, studies show variable mortgages end up costing less.

Many people just find the peace of mind a fixed rate mortgage offers too hard to resist.

With a fixed rate mortgage you pay the same amount of interest over the entire term (not amortization period) of the mortgage. The term on a mortgage can be from 1-10 years.

With a fixed rate mortgage you can also increase your payments to pay off your mortgage faster without affecting the interest rate.

Another advantage to fixed rate mortgages is that when interest rates are low, locking in a good rate can be a great move especially if you plan on owning the home you are purchasing for the entire term.

They're also a wise choice if your income is going to remain relatively steady. In this situation, a fixed rate will help you plan your expenses without having to worry about what mortgage rates are doing.

Typically, interest rates on fixed rate mortgages are higher than variable rate or floating rate mortgages. That's because if mortgage rates go above the rate you're locked in at, the lender has to pay the difference.

However, with a variable rate, the lender has no chance of loosing money.

Is A Variable Rate Mortgage Right for You?

A floating-rate mortgage changes according to the current interest rate set by the Bank Of Canada. This means the interest you pay each month can change based on the prevailing rate at the time.

The most common type of floating rate mortgage is the variable rate mortgage.

Understanding Variable Rate Mortgages

There are basically two types of variable rate mortgages, floating payment mortgages that fluctuate with the rate, and those with fixed payments.

Essentially your monthly mortgage payment stays the same, however, the amount of your payment that goes towards paying down the principle changes according to the current interest rate.

This means that the amount of principle and interest can change from one payment to the next if interest rates move up or down.

If rates go up, you pay more interest than and less principle. If rates go down, you pay more towards your principle and less interest.

But in both situations your payments stay the same.

There are some variable rate mortgages that have payments that change in accordance with the current interest rate.

With variable rate mortgages, borrowers must accept the possibility that interest rates could go up or down from one payment to the next. Lenders allow the borrow to convert their mortgage to a fixed rate at anytime in exchange for this.

As mentioned before, a variable rate mortgage usually has a lower interest rate than a fixed rate mortgage because the lender does not lose any money if interest rates increase.

How To Get a Mortgage With No Down Payment

If you're like most people, putting together a 20 percent down payment on the purchase price of a house or condo can often be difficult.

But the good news is you can still get a mortgage. The not-so-good news is there may be some extra fees involved.

If you're unable to come up with 20 percent of the purchase price, you may still qualify for a high-ratio insured mortgage insured by the Canada Mortgage and Housing Corporation (CMHC), Genworth Financial Canada or AIG.

High-Ratio Insured Mortgage

Many first time home buyers find it difficult to come up the full 20 percent down payment required to get an un-insured mortgage.

Considering that would be $40,000 for a $200,000 - home you can see why.

If you don't have that much saved, you can pay a bit more and get an insured mortgage with the assistance of one of the three organizations mentioned above.

You follow the same steps and processes that you would if you were getting a regular mortgage but you also get your mortgage insured by either CMHC, Genworth Financial Canada or AIG.

This provides protection for the lender and still allows you to buy your house.

Depending on how much you have saved, the extra fees can be up to 3.15 percent of the total mortgage. This fee is incorporated into your mortgage and you pay it off over a number of years.

No Down Payment

If you are a first time home buyer, you may qualify for a high-ratio insured mortgage that covers 95 percent of the purchase price and your bank will give you the remaining 5 percent down payment.

In order to qualify for this type of loan, you have to be able to show that you can afford your mortgage payments and any other costs associated with owning a home or condo such as property taxes, condo fees, and utilities.

CMHC and Genworth Financial Canada will not allow you to spend more than 32 percent of your gross income on home or condo related costs.

It's a good rule of thumb in general not to spend more than 30 percent of your gross income on home related costs.

In addition, if you have credit card debt or any other debts, these organizations won't let you spend more than 40 percent of your total household income on your debt and your housing costs combined.

While the "no down payment" option allows many first time home buyers to afford a property that would otherwise be unattainable, there may be risks involved depending on your situation.

The Truth About the "No Money Down" Mortgage

n the last half century, the idea of what a down payment looks like has changed dramatically. In order for your parents and grandparents to come up with a down payment on their first property, they would have had to come up with 20% of the purchase price.

That's a $50,000 down payment on a $250,000 house.

Usually this meant borrowing money from family or a very tough period of saving.

That was then, and this is now. It's now possible to qualify for a mortgage with zero down payment.

If your someone looking to move into a home quickly and you don't have a lot of money saved up, you could be eligible for a "no money down" mortgage product for first time home buyers.

This option combined with longer amortization periods have made mortgages much more accessible and affordable for a lot of people.

But wait! This option has risks in a down market

As evidenced by the massive amount of home foreclosures and recent market collapse in the U.S., this was probably a choice many people may now be regretting.

Carrying a mortgage with a zero down payment and a home that is declining in value is not a good financial situation to be in.

Here's why.

The Risks of "No Down Payment" Mortgages

Quite simply, if real estate values plunge and you have zero equity in your house (because you made no down payment), you could potentially be in a situation where you owe more than your home or condo is worth.

Under these circumstances, if you sold your property you would not be able to generate enough from the home sale to pay back the lender or the bank, leaving you in debt.

The crisis facing the U.S. is an unfortunate example of how easily this can happen.

This is not meant to scare you away from the "no money down" option completely. For many people this option could mean the difference between stretching themselves a little to get out of renting and start living the homeownership dream.

It's only meant to help you understand the risks.

If you are considering this as a mortgage option some important factors to consider in a down market are:

- Job security
- Having a back up plan
- Safety net (family loan, other assets, ect.)

What Everybody Should Know About Credit Scores

Want to determine what kind of mortgage deal you are going to be able to get?

You might be surprised to know that you began this process long before a mortgage loan was even on your radar.

Getting a great deal on a mortgage is not something any broker can just make happen. The onus is on you to make it a possibility.

And a major factor affecting that possibility is your credit score.

What's a credit score?

It's based in large part on your credit history.

Remember your first credit card? Or how about all those late cell phone bills? What about those student loan payments?

These are all factors that contribute to what's known as your credit history.

It's your credit history in conjunction with other factors such as your income, assets, and liabilities that will determine who gets a great deal on a mortgage, and who doesn't.

The first thing any bank or lender will do when you apply to borrow money for your mortgage loan is pull up your credit score.

And unfortunately, a less than stellar credit rating can affect your ability to get the best mortgage rates.

Your credit score, or FICO score, is a number that major credit-rating agencies assign to you based on your credit history. It can range anywhere from 300 to 900.

Since your credit score is based on your credit history, this signals to lenders that whether you're a good risk or a bad risk.

At high credit scores (750 and up), lenders offer a quick approval at the best possible rates. This score says the person is reliable and responsible with debt. At lower scores (below 620), you could pay a premium on your borrowing rate and possibly even find it difficult to qualify.

How to Check Your Credit Report and Credit Score

Getting a copy of your credit score is an important part of the mortgage application process.

Even if your not quite ready to apply for a mortgage its a good idea to get your credit report to make sure your personal information is accurate and you haven't become the victim of identity theft.

You can get your credit report from one of Canada's three credit reporting agencies but it is strongly recommended that you get a copy from each one as they may not necessarily be the same.

Credit Report

There are multiple ways to get a copy of your credit report from the three credit reporting agencies but mail or internet are the safest. For regular mail it's free but for an online request there's a fee.

Make sure you contact the agency to find out what pieces of identification are required.

Credit Score

The only way to get a copy of your credit score is online through the credit agencies' websites. Your credit score comes with a copy of your credit report a few minutes after you make the request. There is a fee involved.

Canadian Credit Agencies

Here's who to contact for your credit score and credit report.

Experian Canada Inc.
150 King Street West
Suite 805

P.O. Box 68
Toronto, Ontario
M5H 1J9
Tel. (toll-free): 1-888-826-1718
Fax (toll-free): 1-800-646-5876
Web site: www.experian.ca

Equifax Canada
National Consumer Relations
P.O. box 190, Station Jean-Talon,
Montreal, Quebec H1S 2Z2
Tel. (toll-free): 1-800-465-7166
Fax: 514-355-8502
Web site: www.equifax.ca

TransUnion Canada
All provinces except Quebec:
Consumer Relations Centre
P.O. Box 338 LCD 1
Hamilton, Ontario L8L 7W2
Tel. (toll-free): 1-866-525-0262
Fax: 905-527-0401

Quebec Residents:
TransUnion (Echo Group)
1 Place Laval
Suite 370
Laval, Quebec H7N 1A1
Tel. (toll-free): 1-877-713-3393
Fax: 905-527-0401

Web site: www.transunion.ca

Once you have your credit report you'll have a better idea of where you stand and how lenders will view your mortgage application.

If your score is not what you hoped it might be and you want to work towards improving it, you have to understand how your score is compiled and target those areas.

The Secret to Improving Your Credit Score

Do you want to improve your credit score?

You may not realize how much money your credit situation is costing you.

If you have large credit card balances, too many credit accounts and have missed making some of your payments, you'll probably have some strikes against your credit score.

The first thing you should do is make sure you have copies of your credit report from all three of Canada's credit agencies. There is a good chance there could be some inaccuracies or errors in your report that may be negatively affecting your credit score so this is a good place to start.

Known as a FICO score – with a range from 300 to 900 – your credit score tells lenders what kind of a risk you are likely to be as a borrower.

The Five Factors that Make Up Your Credit Score

Your score is based on the following five attributes, with some attributes weighted more heavily than others.

- **Previous payment history** (approx. 35% of score): Your track record of paying your credit accounts on time is the most heavily weighted attribute. Events such as late payments, collections, judgments, liens, foreclosures, bankruptcies, and wage attachments are part of this category and are considered quite serious. More recent events and large amounts will affect your score more than older events and small amounts.

•**Current level of indebtedness** (approx. 30% of score): This portion of the score considers whether you are overextended or not. Too many credit cards or keeping your accounts at or near their maximum limit can signal that you don't manage credit responsibly, and that you may have trouble making payments in the future.

•**Length of credit history** (approx. 15% of score): The longer you have had credit in good standing the lower the risk indicators. This score considers the age of your oldest account and an average age of all of your accounts. New accounts will therefore lower your average account age.

•**Pursuit of new credit** (approx 10% of score): Opening several credit accounts in a short period of time is a risk indicator. The number of enquiries done on your behalf can also have an effect. However, FICO scores try to differentiate between rate shopping for a single loan and searching for many new credit accounts.

•**Types of credit available** (approx. 10% of score): This attribute considers the mix of credit accounts you have: credit cards, retail accounts, installment loans, accounts with finance companies, and your mortgage. The goal is to determine if you have a healthy mix of credit. For instance, having a car loan, mortgage and credit card is more positive than a concentration of debt in only credit cards.

Improving Your Credit Score

The first thing you need to understand is that there is no magic bullet. That being said, by understanding how your credit score is calculated, you can begin to target those areas to try and make improvements.

Your credit score captures your perceived lending risk at a moment in time: your score can change from month to month. The companies that hold your credit accounts and loans report transactions to credit bureaus regularly.

That's a great opportunity for you, because it means you can improve your score with the right credit "behaviours".

Examine the five factors that affect your credit and see what opportunities already exist for you to start making improvements. Here are some tips that can help:

- High interest credit card are the worst kind of debt. Pay these debts down first above all other debts.

- Don't have a credit card yet? You need credit history to get a mortgage so get yourself a credit card at the lowest possible interest rate - but be disciplined about purchases and pay your bills on time!

- Limit your types of credit. You don't need more than one credit card so don't sign up for that credit card in exchange for a free t-shirt at a sports event.

What areas of your credit score are you struggling with and which ones have you not cultivated enough?

The earlier you get a copy of your credit report and target your weak points, the easier it will be to qualify for a great rate when it comes time to apply for a mortgage loan.

Warning: Are You Budgeting For These Mortgage Fees?

There are a bunch of miscellaneous fees that come with getting a mortgage known as closing costs.

Some of these fees may be negotiable and some are set. They can cost thousands of dollars so it's important that you budget for them appropriately.

Planning for these costs ahead of time will also remove any surprises or difficult last minute hurdles when purchasing a home.

Mortgage Insurance

If you get approved for a high ratio mortgage, you will have to pay mortgage insurance provided by the Canada Mortgage and Housing Corporation, Genworth Financial Canada or AIG.

This will range anywhere from 0.5 percent to 3.15 percent of the total loan amount.

This protects the lender and ensures the loan will be repaid even if the borrower (you) defaults. The insurance fee is determined by a formula so there is no room for negotiation. Typically it's capitalized onto your mortgage.

Property Appraisal

Lenders have the option to require a property appraisal of your prospective home. They may also choose the professional appraiser to determine the market value of the property. Generally a real estate appraisal will cost approximately $250.

Most banks will require an appraisal of the property prior to granting a mortgage. In the case of hi-ratio mortgages, the application fee of $165 includes a market value appraisal.

Land Transfer Tax

A land transfer tax is exercised by some provinces on all property transactions. It is usually determined as a percentage of the total cost of the property. Some municipalities, like Toronto, have also legislated land transfer taxes.

Goods and Service Tax

GST is charged on all new homes and condominiums, but if you pay less than $450,000 for a property than you may be eligible for a rebate.

Keep in mind that GST will also be charged on services related to closing costs like legal fees.

Legal Fees

Legal fees typically cost about 1.25 percent of the price of an average house. You'll need to hire a lawyer to assist with the legal details of home ownership transfer, preparing all the mortgage documentation, and searching the title of the property.

Generally these fees are deducted from the mortgage loan itself.

Property Survey

Most lenders require an accurate survey of the property you are purchasing to ensure it's in accordance with all relevant by-laws and zoning.

The sellers agent will often provide a copy of the survey but if not you will be required to provide one. Surveys usually cost anywhere from $200 up to $1000.

As an alternative to a survey, the majority of lenders will accept proof of title insurance which will cost about $250.

House Insurance

Proof of insurance against fire and damage is usually required by the lender before or at closing before giving you the loan. Try and shop around for a good policy.

While these fees may come as an afterthought for many home buyers caught up in the excitement of their purchase, they are critical to get squared away so your home buying experience is everything you wanted it to be - smooth.

Make sure when you are budgeting for your mortgage that you take these fees into account because they add up.

When you decide on a mortgage planner, they will be able to help you with understanding these fees better and hiring professionals to help make the details less stressful.

Your Next Step

Now that you know how a mortgage works, it's time to learn how to get pre-approved for one.

Mortgage pre-approval is the critical first step in the home buying process. Most real estate agents require you to get pre-approved for a mortgage before they start working with you. That's because they need to know they aren't wasting their time on someone who's not qualified.

And if you're wondering what's involved in the pre-approval process, don't worry I've got you covered with an email course that's totally free.

Free E-Course: Zero to Mortgage Pre-Approval

Everything you need to know to get pre-approved for a mortgage - made simple.

I've put together a free email course for you. Each one gets delivered to your email inbox about every 3-4 days.

I wanted to create a straightforward, simple way that you could get a good grasp of the mortgage pre-approval process.

Plus you'll get bonus content that should help you when you go to your next open house.

So If you'd like to learn more about how to get pre-approved for a mortgage, especially in order to start moving quickly towards owning your first home, and you'd like to do that completely for free, follow the link below:

Free E-Course: Zero to Mortgage Pre-Approval

Thanks for taking the time to read this report, I truly appreciate it.

If you enjoyed it and found it helpful, feel free to share it.

And if you have any questions about your own situation, simply send me a note or give me call.

Jay Calafiore
Publisher
www.mortgageblogger.ca

Mortgage Architects | Mortgage Planner
416.236.9300 x 13
jay.calafiore@mtgarc.ca
FSCO Agent # M08000767 / Brokerage # 10287