A First Time Home Buyers Handbook

MORTGAGES *For* MILLENNIALS

ALEX LAVENDER

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Foreword

“I’ve known Alex for nearly 4 years now. The trajectory of his career and life are nothing short of amazing, the fact that I’m sitting here writing the foreword for this young mans first book is proof of that. Alex, is kind, thoughtful, ambitious, yet incredibly generous with his time, praise and advice which showed up through out these pages. The only thing more exciting than what this book will do for the reader is the thought that Alex is just getting started.”

Chris Turcotte - President of Centum Financial Group

“I’ve had the opportunity to watch Alex grow and develop his skills over the last four years. He has become an integral part of the Clinton Wilkins Mortgage Team. His attention to detail, and client-centred focus, makes him a great resource and partner for consumers looking for unbiased advice when shopping for a mortgage.

Alex has the drive to educate and inform consumers about their options and to distill complicated information to make mortgage lending more accessible for his clients. This resource should offer more information to help consumers understand their options and build their financial future. I am excited for you to read this and hope that it helps you, wherever you are on your homeownership journey!”

Clinton Wilkins – Clinton Wilkins Mortgage Team

Preface

Why do I get up at 5 a.m. each morning to continue my work on this book before my busy workday? This is a question I constantly ask my bleary-eyed self before the coffee kicks in—but it is this very practice that has allowed me to get this book to the finish line. Once upon a time, I was on the other side. I was in your shoes: completely lost and not sure what information to believe. I made an offer on my first home at the age of 23, and although I thought I had everything lined up, I was denied a mortgage by my bank. I had great credit, a down payment and an income, so I couldn't understand why I didn't get approved. I kept asking the adviser at the bank questions, but even she was unsure, so I never got any information that would help me move forward. All I was told was that my income wasn't high enough (I was a waiter at the time, which I now understand complicated my application through the use of gratuities). The bank never told me what I needed, why I needed it, or how to get my application approved. I was never given any guidance about what I needed to do or what other options were available to me. At the end of the day, they were a bank—they offered a product and if I didn't tick their boxes, it was a hard decline and a "try again next year." Looking back, I wish that I had visited a mortgage broker to get the valuable knowledge I needed back then.

However, this rejection immediately launched me onto a journey of education to learn everything I could about mortgages. I wanted to know the dynamics inside and out. I started by searching the internet for every little detail I could find, only to discover that the "facts" presented on one website were completely contradicted on another website. If you want to see this in action, a great example is to try searching for "mortgages after bankruptcy."

One of the major problems with online research arises from pulling information from sites in the United States, which will obviously be based on their policies, or even just obtaining outdated information. The mortgage industry is constantly evolving and changing, so I hate to say it, but take mortgage advice from your parents and grandparents with a grain of salt.

After the internet left me more confused than when I started, I decided to take a different approach. I enrolled in a mortgage agent's licensing course. I figured what better way to get all of the information I needed to understand mortgages, right? I envisioned that when I passed this course, I would be the expert authority on mortgages. Well, I was wrong. Very wrong. The course focused on the ethics and fundamentals of operating as a mortgage broker, but it did not teach me anything about how to complete transactions and which applications get approved or declined. That is because the only way to truly learn the ins and outs of mortgages is through firsthand experience of funding them—a lot of them! That's the experience that I hope to share with you in this book. No two lenders are the same; that is why there is so much conflicting information out there. The power of an independent mortgage broker is that we have access to almost every lender in the market, and sometimes it comes down to that one lender's policy that makes the difference between a mortgage being approved or declined.

As I started working as a mortgage broker, I personally witnessed the frustration and disappointment of hopeful first-timer buyers who would come into my office in a cloud of confusion from Google. It prompted me to reflect on my journey too. That's when I realized that I could be in a position to step up and set the record straight. I could provide an up-to-date and realistic guide to getting that first mortgage. I wrote this book so that you don't have to go through what I went through. My years of experience as a mortgage broker and the numerous lessons I learned along the way are all detailed throughout the following chapters to help you stand the best chance of securing a mortgage. I cover essential information like how much you really need for a down payment, the minimum credit requirements (and how to fix your credit if required), and I even share a very accurate calculator that you can use to figure out how much you qualify for. As a millennial myself, I've seen friends, family members and colleagues struggle through this process, becoming increasingly stressed, confused and overwhelmed. Times have changed since our parents and grandparents bought their homes—the old rules no longer apply. My goal is simply to help out my fellow millennials (or any first-time home buyer) by empowering them with all of the knowledge they need to buy their first home with minimal stress. Buying your first home shouldn't feel like an impossible or insurmountable challenge—it should be simple, straightforward, exciting and just a little bit scary.

Who Am I?

My name is Alex Lavender. I work for Centum Home Lenders in Dartmouth, Nova Scotia. Our team is one of the top-producing brokerages across Canada with Centum, taking the #1 title for most mortgage units funded in 2019. I was ranked #5 within our company nationwide during that time. Since starting work here in 2016, I have been fortunate enough to receive our Optimus Gold, Optimus Platinum and New Entrepreneur of the Year awards. How did I do it? A great mentor, a crazy work ethic, and the drive to see no file ever get declined—all fuelled by a passion to genuinely help people and provide the absolute best service possible. I focus on three main types of lending: (1) first-time home buyers, (2) alternative lending and (3) construction mortgages. I love working with first-time buyers because nothing feels better than sharing my knowledge, teaching people how everything works and helping them use that information to get what they need. Alternative lending (also known as Alt-A, B or private lending) is where I really get to shine. I have always loved problem-solving with numbers, and I would definitely say that this is my true calling. Alternative lending is for people who do not qualify with a traditional bank mainly due to their credit, income or other factors. Construction mortgages are becoming increasingly difficult to find and get approved for these days. I have positioned myself as an expert in this type of mortgage by helping my clients to navigate all the steps and processes required to build their own home.

I would tell you to check out my Instagram page, but I'm sure we'd both agree that it's hard to post great photos of mortgages. So, instead, consume this book, educate yourself, tell your friends to get a copy, and hold on to it as a guide you can refer back to later.

Why use a mortgage broker?

A mortgage broker is a one-stop shop that looks out for your best interests. You can think about it on a much smaller scale like this: If you are purchasing a TV, you can either go directly to the company's store or to a big box store that supports a wide range of brands. If you go directly to the brand's store, the rep there can tell you about all of that company's products that are available. However, there aren't other brands available to you, so you can either purchase their brand or go elsewhere. That's it. Plus, that salesperson's commission is directly tied to selling you their product. Now, on the other hand, imagine going to a big box store that sells dozens of different TV brands. That sales representative is not biased about which brand of TV they sell you. They simply ask you some questions to find the exact model, type, features, etc. that you want. It doesn't matter to them which brand you choose because their commission is derived from selling any TV on the shop floor.

This is a similar to approaching a mortgage broker versus a bank. Each lender has their own specific set of guidelines and principles. That is the power of a broker. They have the ability to navigate through each of the policies to find the lender that perfectly fits your needs. At the end of the day, it is not all about the rate. Different providers offer different options, such as lower penalties to break a mortgage, increased pre-payment privileges, higher renovation budgets that can be built into a mortgage, and so on. Imagine a broker as a one-stop shop in comparison to a bank that only sells their own product. Additionally, different lenders have different guidelines, which means a broker has more options to help you get approved compared to a bank.

Top reasons to use a mortgage broker:

- **Work for you, not the bank**

  Mortgage brokers are here to work for you, not for one specific lender. When you go to the bank, the representative you speak to is an employee of the bank and has to look out for the bank's best interests. When you deal with a broker, however, they are not tied to any particular lender and will search for the solution that fits you best.

- **More accessible**

You're busy! Between work, family, friends, the gym and hobbies, it's hard to find the time to make calls to get additional information or updates. Unlike banks, most mortgage brokers do not operate on a 9-5 schedule. A lot of great brokers out there will be available to you in the evening hours and on weekends. This not only helps speed up the overall process but also means you can contact them for those questions outside of office hours.

- **Wide array of lenders**

Unlike banks that can only offer their product, a broker has access to a wide array of lenders. This allows them to shop around to find you the best rate on the market, as well as the best terms. Every lender has their own unique set of policies that will increase your chances of approval and the amount you can qualify for. For example, some banks do not accept Child Care Benefit income. However, as brokers, we have access to lenders that do, which can make a huge difference to the amount you qualify for. Do you have large student loans that you're still paying down? (Who doesn't, right?) No problem! We have access to lenders that will reduce your debt obligation by a third compared to other lenders.

- **100% free**

The services mortgage brokers provide are 100% free and come at no cost to you. If you purchase a home through a traditional "A" lender, there are no fees. Mortgage brokers are compensated by the lender, so we don't get paid unless your mortgage is funded. Therefore, making sure you are completely satisfied and that we get you approved is our top priority. Now, if you are unable to qualify with a traditional lender due to credit or income and you would to explore alternative or private lending, then there might be a fee associated with this type of solution. These are higher risk mortgages that give consumers additional options when the traditional route is ruled out, and due to that higher risk, they do have higher interest rates and lender fees.

- **Long-term relationships**

Working with a broker is all about creating a long-lasting relationship. You're more than just another name and case number in a massive database. Having someone who knows your file is very beneficial for future transactions and changes to your mortgage. For most people, their first home will not be their last home, so having the ability to contact someone you trust and who knows your situation is ideal. Since brokers are self-employed and don't work for a specific financial institution, you don't need to worry about them switching banks and no longer being able to help you.

- **Support local**

One of the best things about using a broker is that you are supporting a local business. There are a lot of great brokers out there who give back to their community, whether it be through donations or volunteering. Do you have your own business? What a great opportunity to connect with a potential referral source for your business. I always make it a priority to reach out to one of my previous clients whenever I need a service they provide.

- **Reputation**

A mortgage broker's business is built on reputation from referrals and past clients. We cultivate strong relationships, so when anyone hears the word "mortgage",

> they instantly think of our name. Great reviews, especially online, are the backbone of a mortgage broker's business. If we don't have a good reputation, we don't have clients, which in turn means we have no business!

This book is given completely free of charge (paperback at cost), and in return, I only ask one favour of you: *seek out a mortgage broker for your next transaction.*

The purpose of this book is to educate you, the consumer. If you would like to work together, I would be honoured to do so. If you are located outside of Nova Scotia, that's not an issue. I complete transactions all across Canada. If you are searching for your own broker, do your research and ensure you find one who is rated highly by others on a reputable platform, such as Google or Facebook. Brokers are truly there to look out for your best interests, and the best part is their services are completely free for traditional financing, just like a bank. Using a broker who eats, breathes and sleeps mortgages and who is always available to you will far surpass your experience with a banker who is only available from 9 to 5—when you're busy with work and life! If you are planning to use your bank's mortgage specialist, just Google them first to see what kind of reviews they have. Oftentimes, they will not have any reviews as they can hide behind the bank when things go wrong. In contrast, brokers are individuals. We put our names and reputations on the line, so we take our reviews very seriously. If a client doesn't have a great experience or we drop the ball, we know that our reputation could be tarnished forever.

Before we start:

I make a lot of general assumptions in my book. I explain the concepts as they relate to the Nova Scotian market. Mortgages are regulated on a federal level and the rules tend to be consistent on a national level. The product offering, however, can vary from province to province as these cater to the local markets and the lenders who operate there. For instance, the rules for a $0 down mortgage are the same across Canada. However, they may only be available in certain provinces as it's the lender's choice as to whether they want to provide this type of mortgage or not. Someone buying a home in downtown Toronto may receive a lower rate offering than someone buying in rural Nova Scotia due to the competition in these markets.

Due to the ever-changing landscape of the mortgage market, some of these products or concepts may no longer be in effect or may have changed. While every effort has been made to ensure all information is correct and up to date at the time of publication, do not take anything in this book as fact. It is meant to be a guide, providing a comprehensive general understanding of mortgages. This book is also focused on Nova Scotia's lending policies, so be aware that your province may have different policies or may have more or less programs available for certain situations. Always verify this information with a mortgage broker before making a decision.

The assumptions made in this book are general guidelines, so exceptions may apply to some rules. Mortgage rules are similar in some ways to how the law is interpreted in court: there is that grey area that leaves some things open to interpretation on a case-by-case basis. Mortgage lending is not always black and white; it is dynamic and almost every situation is unique. That is why it so difficult to create guidelines suitable for every individual's exact situation. This book sets out the general principles that will help you most and is intended to serve as a reference you can return to in order to make informed decisions when purchasing your home. All information should be verified with a mortgage professional based on your specific situation in your geographical area. If every exception and variation were included in this book, it would be a hefty and overwhelming textbook of complexity and confusion. The point is to provide a very solid understanding of the overarching principles of mortgage lending and how to get approved. If you ever want to talk about your situation or get pre-approved, please don't hesitate to reach out. I am more than happy to help.

Mortgages 101- Basics, Fundamentals and Terms

HOW THE HOME BUYING PROCESS WORKS

Congratulations! You're finally at a place in your life where buying your first home seems achievable. You're scared but excited, intimidated but optimistic, nervous but determined. Buying a home can be a huge rollercoaster of emotions with so many moving parts.

Just imagine for a moment that you're out with your realtor looking at homes. After viewing a half-dozen or so, you arrive at the doorstep of your dream home. The moment you walk in, you instantly envision you and your family living there. It's the perfect place; the one you've been dreaming of all this time! Unfortunately, you're not the only one who thinks they've found *The One.* There are 20 others who have viewed this home due to its unbeatable location and below-market price. You proceed to make an offer that's substantially over the asking price—no one is getting in the way of you and your dream home. The offers are presented; the seller decides to go with someone else. Your offer is declined. You are heartbroken. You just can't see past this home; every other house you view just doesn't compare. You're feeling defeated and losing hope.

Then, five days later, you get a call from your realtor. The other offer on the home fell through… and yours has been accepted! Everything changes with that quick phone call. You are ecstatic, jumping with joy! There's hope in this again. You call your mortgage broker and he begins to prepare the financing. You call the property inspector to set up a time to view your future home. You feel like things are finally coming together and start telling all of your friends about your new home. You've got Pinterest boards, design ideas and paint choices figured out, and you already know how you're going to add your special touch to each room. Then the property inspection reveals that there is a major structural crack in the home. Without digging up the foundation, they don't know whether this is a simple patch-up procedure or a full-blown reconstruction project that could cost tens of thousands.

You're already emotionally invested in this house. You've told all of your friends and family about your dream home, so what do you do now? Do you act on emotion or logic? This common scenario just gives you a glimpse into the emotional roller-coaster that buying a home can be. Is it always like this? No, it's not, and trust me, I hope this is not the case for you. I want it to be a simple, straightforward and enjoyable process for you. I just want you to be aware of what the process may look like and prepared for the unexpected things that can come up. I always go by the motto "everything happens for a reason." There have been numerous occasions where I have seen that first offer fall through on a client's "dream home", just to have them look back and be so grateful that they found the home that they have today. My best advice is to not emotionally commit yourself until your financing and inspection conditions have been met. Telling your friends and family about your new home before you have all the facts ties you to it and clouds your judgment. Once you have been fully approved for financing, the property inspection has come back up to your standards, and the offer has gone firm, then you can tell every person you know. Throw a party, pop some bubbly, show them all your design ideas and paint swatches until they can't tell one from the other. The odds of something falling apart and the house not closing after the conditions are met is very slim.

Here is a generalized outline of how the process works. I'm not going to get into the nitty gritty details here as there are a lot of items outside of the scope of mortgage financing that occur in the transaction. This is just to give you a rough idea of how the process goes.

1. **Get pre-approved for mortgage financing –** Before you even begin to look at homes, you should get pre-approved. There is no point in getting your hopes up and looking at homes only to find out later that you do not qualify for that amount or that there is something holding you back from getting approved. A pre-approval will not only tell you the maximum house price you qualify for, but it will also allow you to have a realistic idea of how much your monthly payments will be.
2. **Start searching for homes with a realtor –** A good realtor acts in your best interests. They are free for the buyer to use and they will not only negotiate to get you the best price but will also provide valuable guidance and reassurance throughout the process. As a new buyer, it is very important that you have someone who can guide you. It is NOT recommended to use the same realtor who is selling the house you are looking to buy. They have an obligation to look out for the seller's best interest first and not necessarily yours. However, the exception is new construction homes as the price tends to be firm with the builder, so using the listing agent in that scenario can be acceptable.

3. **Make an offer –** Once the offer is made, you will need to wait until it is accepted. This is usually within 48 hours. After the offer is accepted, you will have an accepted purchase and sale agreement with the sellers of the home. Your offer has a couple deadlines, but we will explain the two main ones here that are related to mortgage financing. The first date is the conditions date, which is typically around seven business days from the time the offer is made. The second date is the closing date. The conditions date is the time you have to get all of your financing approved and your inspections completed. When this date arrives, one of three things will happen. You will either:
   a. Waive the conditions, which means the deal goes firm and you have bought the home;
   b. Terminate the agreement because you were unable to meet the conditions or the house is not up to your standards; or
   c. Request an extension for more time if something unexpected has come up or there has been delays in the process.

After the deal goes firm, you are in a binding contract with the seller to purchase the home on the closing date.

1. **Get approved for the mortgage –** One of these conditions is the condition of financing. When an offer is made, you will need to have your realtor send it to your mortgage broker right away. Check in with your broker to ensure they have received it. The broker will send this offer in for approval. Once the mortgage is approved, a commitment will be issued. From the time the broker

submits the offer to the time a commitment is received typically takes 48 hours. A commitment is essentially a conditional approval. It outlines all of the terms and conditions from the lender and states the documents they require to approve the file. The standard documents they will ask for will be in relation to income and down payment, but additional documents may be required for each individual circumstance. These documents are outlined in subsequent chapters for specific situations. You will need to bring these documents to your broker and sign the commitment. After that, your financing can be approved!

2. **You wait –** This is the hard part. You've done your part, everything is approved, and the condition period has passed. Now, you essentially play the waiting game. Sometimes, this is non-existent and sometimes it's so long you forget that you just purchased a house to begin with. About a week before the closing date arrives, your lawyer will meet with you to sign the final paperwork and obtain a bank draft for the necessary funds. At this point, the best advice I can give you is to ensure that you meet with your lawyer at least two days before closing, especially if your closing date is a Friday! I have witnessed firsthand scenarios where a client goes in to sign on the morning of closing only to forget a crucial item that has been requested. And when it's Friday, you can be certain that nothing is going to be happening until Monday. This creates a domino effect when the seller of the home you are purchasing has their own offer on another home that is supposed to close that day. You

can see how your transaction can impact others who are relying on this sale.

3. **The house closes –** You do your final walkthrough and the house is finally yours. Congratulations—you're officially a homeowner!

A word on home inspections

Unless you are buying a new construction house or a condo, practically every property is going to have something wrong with it. Whether its asbestos in that home built in the 1930s or roof shingles that have been ripped off in the last storm. A home inspector's job is to find all of the defects in the home. They are only there to present the facts, so ultimately, it's up to you to decide what the correct course of action is.

MORTGAGE TERMS

The first thing you must understand is what a mortgage actually is. In its most simplistic terms, a mortgage is a loan that is secured against a real estate asset with payments charged at a prescribed interest rate. Here is the breakdown of traditional mortgage terms.

Here is an example of a mortgage contract

Loan

Purchase Price:	$105,265
Down Payment (5%):	$5,265
Net Mortgage:	$100,000
Mortgage Default Insurance:	$4,000

Total Mortgage:	$104,000
Loan to Value:	95%

Terms

Interest Rate:	1.95%
Term:	5 Years
Amortization:	25 Years
Style:	Closed
Type:	Fixed

Payment

Principal and Interest:	$438
Estimated Property Tax:	$1,200
Taxes Paid By:	Lender

Purchase Price

This is the agreed upon purchase price that you will be purchasing the home for.

Down Payment

This is the amount of money you will be providing out of pocket for the real estate transaction. The rest will be mortgaged and provided by the mortgage lender.

Net Mortgage

This is the amount that results once the down payment is deducted from the purchase price.

Mortgage Default Insurance

If you put 20% down, you will not incur mortgage default insurance. If you put less than 20% down, it will be mandatory. Essentially, mortgage default insurance protects the lender if you stop paying on the mortgage. The premium does not need to come out of your pocket directly. It is rolled back into the mortgage, as you can see in the example above. Essentially, it is subtracted from your down payment. A further explanation on this will be provided later in the book.

Total Mortgage

The total mortgage amount is the purchase price less your down payment, then add the mortgage default insurance premium (if applicable). Essentially, this is the amount your mortgage payments are calculated from and is the total outstanding balance of your loan.

Loan to Value

The loan to value is expressed as a percentage that represents how leveraged the home is. If you had a 20% down payment on a home, you would have an 80% loan to value. It means 80% of the value of your home is being paid for with a loan.

Interest Rate

This is the rate of interest that the lender is charging on the mortgage. The rate mixed with the amortization is what determines your monthly payments for the mortgage.

Term

A mortgage term is the length of time that you and the lender agree that you remain in the contract for this mortgage. For instance, if you get a five-year fixed rate at 1.95%, the lender will provide that rate for those five years. However, in return, they will expect that you will not break the mortgage. If you break the mortgage, then you will incur a penalty. The standard and most common mortgage term in Canada is 5 years in length.

Amortization

I like to think of amortization as the life of the mortgage. It is reflected as the period of time it would take to pay your mortgage in full. In today's mortgage market, if you have less than a 20% down payment, the maximum amortization period is 25 years. If you put down 20% or more, you can increase the amortization to 30 years. If you shorten the amortization, the payments will increase. Likewise, if you extend, the payments will decrease. However, keep in mind that the shorter the amortization period, the less you will pay in interest over the life of your mortgage.

Example:

Say you have a mortgage of $100k at a 3% interest rate on a five-year fixed term with a 25 year amortization and the monthly payments are $473 per month. Assuming that you are able to renew every year at the exact same interest rate, then it will take you exactly 25 years to pay off this mortgage in full. So, what happens when the rate increases at the end of the term? In almost every case, the rate will change at renewal, whether it be higher or lower than the previous term. In our example above, at the end of the five-year term, if rates increase to 3.50%, then your payments will increase to $499 per month with 20 years left on the amortization.

Style – Open or Closed

An open or closed mortgage relates to the term of the mortgage and whether it will have pre-payment penalties. Almost every mortgage for a new purchase will be a closed-term mortgage. If you are in a closed mortgage and you break it before the end of the term, you will incur a penalty. However, if you are in an open-term mortgage, you can break it at any time and there will be no penalty. I know what you're thinking: why doesn't everyone do an open-term mortgage then? That is because the interest rate is significantly higher—typically around 3% more than a traditional rate. An open mortgage term is not common and is typically only used when someone has their home up for sale. This will allow them to sell at any time without incurring a penalty.

Type – Fixed or Variable

Mortgages in Canada come in the form of either fixed or variable terms for interest rates.

Fixed

A fixed term is a mortgage that will have a locked-in rate for the term that you enter. The downside to this type of mortgage is that the penalty can be greater if you need to break it before the end of your term.

Variable

A variable-rate mortgage has the ability to move up and down over the term. What the lender is guaranteeing you is a discount on prime. So, for example, if you have a prime – 1% mortgage and the prime rate is 4% today, that means that your rate is currently 3%. If that rate drops down to 3.5%, then your rate will drop to 2.5% and vice versa.

Fixed Versus Closed not to be confused

The words "fixed" and "closed" tend to be misunderstood, so it is worth delving into these in further detail. If you hear that a lender is offering a five-year "closed" mortgage, you could actually be entering into a variable mortgage where your payments could move up and down with changes in the interest rate. Whenever you hear the word "closed" in mortgage terminology, it is always referring to the ability to pre-pay on the mortgage. Almost every mortgage that you will encounter will be a closed mortgage as open mortgages are used only in very specific situations. The key word you need to look out for is "fixed". A fixed mortgage is one that will not move and will stay the same over the term. Ensure that you don't overlook this seemingly minor detail as you may in fact be getting yourself into a variable mortgage when you thought you were getting a fixed one.

Payment – Principal and Interest

This is the payment amount. It is calculated from the terms of the mortgage. The payment directly relates to the combined interest and principal you pay on the mortgage every month.

Estimated Property Tax

This is the estimated annual property taxes for this property. On some properties, it can be verified with an existing tax bill, but on others, such as a new construction, it is an estimate. This amount will always fluctuate each year as it is re-adjusted by the municipality.

Taxes Paid By: Lender or Borrower

When it comes to property taxes, you have two options for payment. If you are paying the taxes yourself, also known as "borrower paid", then you remit payment directly to the municipality when it is due. This is typically required on a semi-annual basis. The other option is to have the lender take a portion of the taxes when each of your mortgage payments occur, known as "lender paid" taxes. They will set this money aside in a separate account. When the tax bill is due to the city, they will remit payment on your behalf. The lender paid option is more favourable for a first-time buyer because it allows for a sustainable and consistent payment compared to a large lump sum twice per year.

Deciding Between a Fixed or Variable Mortgage

Different lenders treat rate changes in their own way, so you must ask what will happen if rates go up or down. Some lenders will increase or decrease the monthly mortgage payments and some will increase or decrease the amortization (life) of your mortgage. However, the most common path is that your payments will change with the interest rate, the lender will notify you, and the next payment schedule will be adjusted accordingly. If you want to share the benefits of a variable mortgage but keep the consistency of the same payment, you must advise your broker of this so they can connect you with the appropriate lender.

Almost all variable mortgages carry a three-month interest penalty, so it's more cost-effective if you ever need to break the mortgage. I always ask my clients if they have any reason to think they may break the mortgage over their five-year term. If you think that you could potentially break the mortgage over the term, then I would highly recommend a variable-rate mortgage. It is worth noting that roughly 60% of Canadians break their mortgage at the three-year mark of their five-year term. Life throws so many unexpected events and challenges our way, so a variable mortgage can be very beneficial. It is also worth noting that, historically speaking, variable mortgages have performed better than fixed-rate mortgages for borrowers.

Additionally, if you have a variable-rate product, almost every lender will allow you to switch over to their respective fixed rate during any period of your term. This fixed rate will be determined at the time you are looking to switch by the lender's current rate offering for that product. If you have a fixed-rate product, you will not be able to switch over to a variable-rate product during your term without breaking the mortgage and incurring a penalty.

Different market conditions may make one option more favourable than the other at any specific point in time. It is a good idea to have this discussion with your mortgage broker to discuss the pro's and con's of each option along with the current rate environment.

I completely understand the concern that one may have where their payments could increase, but even with a fixed-rate mortgage, you are not protected—see below for further details.

The Fixed-Rate Mortgage Dilemma

Many of us fear the variable-rate mortgage because we know it may increase beyond our control. The prime interest rate, also called the overnight rate, is set by the Bank of Canada. This is the rate at which financial institutions borrow funds at the end of the day to ensure their books are balanced. This rate directly influences the prime rates that the banks charge, and almost all of them have the same rate as one another. When the Bank of Canada changes their rates, they typically do so in small increments of 0.25%. A common fear amongst borrowers is that interest rates are going to double and their payments will soar into the thousands overnight. This type of jump would be so incredibly rare (unless you have a massive mortgage, as it's relative). Just think what would happen if the interest rate spiked massively in the economy for our heavily indebted country. Defaults would run at such a high level amongst all borrowing categories that it would trigger a financial collapse. Let's use an example to better illustrate this.

Example:

John has just obtained a mortgage for $100,000 on a five-year closed variable rate of 3% (prime (4%) – 1%) with a 25-year term. His monthly payments are $473 per month. The next day, the prime rate increases 0.25% to 4.25% and John's rate moves up to 3.25% (4.25%-1%). His monthly payments then increase to $486—a difference of $13 per month. This means that, as a rough estimate, for every $100k of mortgage owed, the payment will go up by $13 per month for each 0.25% increase. So, for instance, if you had a $400,000 mortgage, you would be looking at an increase of $52 per month ($13 X 4).

The biggest thing you need to understand here is that you are not protected from rate increases with a fixed mortgage. This is because your term will always come to an end. If rates have increased in the market from when you first received your mortgage, you will need to renew at a higher rate. Would you rather have the sticker shock of renewing one day with an increase of $200 a month, or would you prefer to incorporate those increases gradually through four $50 increases over the length of your term?

A Note on Rate:

Rate is not everything, but this tends to be the most common focus. Beyond rate, there a multitude of factors that need to be considered first, such as pre-payment privileges, collateral charge or conventional charge, variable or fixed, closed or open, etc. Using a broker to understand your exact situation and align you with the perfect lender is far more important than rate. Say, for example, you just got a mortgage and were able to secure the absolute lowest rate of 1.94%, while everyone else was offering 1.99%. Your mortgage broker offered you a rate of 1.99% for a five-year fixed through a monoline lender. She explained that this was the perfect product for you because you wanted to have the security of a consistent payment that would not change (fixed mortgage). Since you are in the military, your broker was also aware that you could be relocated at any time and you may have to sell the house, which would mean incurring a penalty. Due to this, your broker aligned you with a monoline lender because she mentioned that if you break the mortgage, the penalty would be much lower than through a bank. Why is that? (Read the section on interest rate differential next to find out)

The next day, you go to your bank to take the money out of your RRSP (Registered Retirement Savings Plan) and mention it is for a home. The bank's mortgage specialist comes in and you start chatting. You told him that you just received 1.99% with your broker and he said he would have no issue getting an exception for you at 1.94% if you get the application in and approved today. You take advantage of the savings of $3 per month on your $200k home and everything goes smoothly, you purchase the home. Two years later, sure enough, you receive the confirmation that you are being transferred and you need to sell your home. You find a buyer and the house sells. On the day of closing at the lawyer's office, you notice a penalty of $6,000 for breaking your mortgage early! You think back to the conversation you originally had with your broker. If you had been aligned with a monoline lender, the penalty would have been closer to $1,000 due to the way these two different lenders calculate their penalties. This is just an example to show that rate is not the most important aspect of securing a mortgage—the product itself and the foresight to ensure you are in the right mortgage is.

Interest Rate Differential

If you have a fixed rate mortgage and you decide to break it before the end of your term you may incur an interest rate differential penalty. It is important to note that there is a significant difference between how a bank will calculate this compared to a monoline lender. The calculation itself is a complex one with values that can change daily as it encompasses the remaining time in the mortgage term, the current market rates, and the outstanding balance. Typically, when you break a mortgage with a monoline lender you will incur a penalty of around 1% of the outstanding balance where with a bank it is around 4%. The reason for this is due to the way the interest rate differential is calculated through the "posted" rate. The banks have a posted rate that is significantly higher than the rate you will receive for a mortgage, however with a monoline lender the posted rate is the same as the one you receive. With a bank they offer you a "discount" off the posted rate so if you break your mortgage you need to cover the spread.

Lets use a simple example to showcase this. You just took out a mortgage for $400k at a rate of 2% with a bank who has a posted rate of 5% and you decide to break it the next day. You will need to cover the spread between the posted rate of 5% and the rate you received 2%, which in this case equals 3%. When we take 3% of $400k we realize that the penalty is $12k to break this mortgage. Lets look at this with a monoline lender, if you received a rate of 2% then the posted rate would also be 2%. So when you subtract the two they would cancel out and equal 0. When this occurs, the lender will have a minimum penalty of 3 months of interest (not 3 months of mortgage payments). When a 3-month interest penalty occurs it typically works out to be 1% of the mortgage amount or in this case around $4k. Although we may purchase a home thinking we will never break the mortgage, we need to understand that life happens. It is always a good idea to be forward thinking and consider the IRD to prevent a large, unexpected penalty from occurring.

Pre-payment Privileges 20/20

Almost all lenders offer pre-payment privileges on a mortgage. This is the amount that you can either put down as a lump sum or increase your monthly payments by in a year without triggering a penalty. Most lenders offer somewhere between 10%-20% pre-payment privileges. You will notice that the terminology is like something out of an eye exam. Typically, the first number refers to the annual amount you can pay as a lump sum, while the second number relates to how much you can increase your payments by. Every lender has their own specific way in which they present their terms. Some will only allow you to make a lump sum on the anniversary date, others will allow you to make a payment at any time. I am just going to provide a general example of how it operates. For example, if you were offered 20/20 pre-payment privileges, you would be able to pay down 20% of your original principal mortgage amount every year. So, even if your mortgage was at $90k today but was at $100k when you first started, you would be able to pay down 20% of the original $100k that you borrowed, not what your current balance is. Also, you would be able to increase your monthly payments every year by 20%, so if your payments were $1,000, you could increase to $1,200 after the first year, then $1,440 after the second year and so on.

Different Types of Mortgage Insurance

There are four types of insurance that come into effect when purchasing a home, and only one-and-a-half of them are mandatory. The one insurance you will always need to obtain is fire insurance, also known as homeowners insurance. The next one that may or may not be mandatory is mortgage default insurance. This depends on whether you are putting 20% down or not. The third type is life or disability insurance. Although this type of insurance is not mandatory, it is highly recommended to help protect your family members. There is also a fourth one called title insurance that protects your legal title ownership of the property.

Homeowners Insurance

This insurance covers any damages or liability claims against your property, from the house burning down to someone getting injured on your property. This one is mandatory by the lender because they are lending money on the asset (the home) and want to ensure that if something catastrophic happens (house burns down), there is adequate coverage to get their money back. The bank is listed as the loss payee on the policy, which means if you have a mortgage, the first person to get paid out is the lender. If your policy is cancelled, the lender will be notified by the insurance company and it will need to be resolved immediately. When you are in the early phases of buying a home, you must ensure that the home is insurable. As you near the closing date, you will need to have insurance approved and ready to start once you take possession. The insurance must be in place before the mortgage can fund. The process of applying for house insurance is similar to that of applying for car insurance, and you can usually use the same provider to get a discount or reach out to your insurance broker for assistance.

Mortgage Default Insurance

Mortgage default insurance is offered by three providers in Canada: CMHC, Genworth and Canada Guarantee. This insurance protects the lender from any loss if you default on your mortgage. Without mortgage default insurance, the lending environment would be dramatically different to how it is today. As a consumer, the main benefit is the ability to have a lower interest rate than a non-insured mortgage.

Whether you want it or not, mortgage default insurance is mandatory when you have less than a 20% down payment for a purchase. There is also a minimum requirement: the maximum loan to value cannot exceed 95%, meaning the lowest down payment you can put on a home is 5%. This is to create equity in the home so that 100% financing is not achieved. However, since the mortgage default insurance is wrapped back into the mortgage, it gets very close to this level. With all of this being said, zero-down mortgages do still exist (and are explained later in this book). They are simply structured in such a way that a 5% equity stake in the home is technically still achieved.

The cost of the insurance depends on the size of your down payment. At 5% down, the premium is 4% of the mortgage amount, 10% down is 3.10%, 15% down is 2.80%.

If you cannot get approved by any of the three insurers, then you will not be getting a mortgage with less than a 20% down payment, no matter which lender is interested in taking it on. The default insurer sets minimum rules that must be adhered to, such as credit score and debt-servicing ratios.

Life and Disability Insurance

This type of insurance, although not mandatory, is highly recommended, especially if you have dependants. When getting a mortgage, you will always be offered this insurance. Your life insurance policy will pay off your mortgage in full if you pass away. Disability insurance will pay your mortgage payments until you are able to go back to work. Every policy has their own set of terms and conditions, so ensure that you go over what is covered and what is not.

In my opinion, it is best to sign up for both life and disability insurance when you are offered it. This will provide you with the coverage you need once you purchase your home. Most policies will allow you to cancel at anytime, and some will even provide a refund if cancelled within the first 60 days (free coverage).

After you get settled into your home, it is a good idea to get a full review of your insurance policies with a financial planner.

You may think you have full coverage from work, but they often cover a lot less than expected. At the end of the day, the most important thing is to ensure that you have coverage in place. After all, your home is most likely your biggest asset and your biggest liability.

Title Insurance

This type of insurance is becoming increasingly more common and is mandatory for some lenders. It costs just a few hundred dollars and is offered by the lawyer at closing. It protects you against any fraud or title defects in relation to your property. It also encompasses other issues, such as invalid easements, encroachments and zoning compliance.

The Three Golden Pillars of a Mortgage

A mortgage is based on three main pillars: Income, Down Payment and Credit. If you can satisfy each of these requirements, then you can get a mortgage. Here is a brief breakdown of each, the following chapters will go into these in further detail.

Income – The requirement to have enough income to service the payments of the mortgage and any other debt obligations you currently have.

Down Payment – The requirement to have a sufficient amount of funds for the down payment for that specific mortgage and the ability to satisfy the verification of these funds.

Credit – The requirement to have not only a good credit score, but an established credit history as well.

THE LENDER MIX IN CANADA

In Canada, there are three main types of mortgage lenders when it comes to residential financing: A/Prime lenders, B/Alternative lenders (Alt-A), and Private lenders. Each of them satisfies a unique need and are explained in further detail below.

"A" Lenders

This is your traditional lender. They offer the lowest rates as long as you can fully satisfy the main three pillars. You need to have good credit, the income to support the mortgage and proof of down payment.

Details

Down Payment:	As low as 5%
Rates:	Lowest in the market
Terms:	Typically 5 years (1-10 Year available)
Amortizations:	25 years with less than 20% down, 30 years with 20%+
Credit Score:	Minimum 600
Location:	Typically, there are no restrictions

<u>Choosing An "A" Lender: Monoline Or Bank</u>

When it comes to "A" level mortgage financing, there are two main types of lenders: monoline lenders and the bank (there are also others, such as credit unions but we won't focus on those here as they vary from province to province). A monoline lender is considered a broker-only lender, meaning they are only accessible through a mortgage broker. They differ from a bank because they only do one line of business: mortgages.

They are not deposit-taking institutions, like your traditional bank, and because of this, they are not on the street corner. That can make some of the names a little unfamiliar. However, they are some of the largest mortgage holders in Canada, collectively holding hundreds of billions of dollars in the Canadian mortgage market. Examples of these lenders are names like: First National, MCAP, Merix and RFA, to name a few.

Why Monoline?

Great question! Since these lenders rely solely on brokers and don't have a high number of fixed locations with salaried employees, they are able to reduce costs and pass those savings along to the consumer. Typically, these lenders can offer better rates, pre-payment privileges and reduced penalties compared to traditional banks. The biggest difference is the reduction in penalties for fixed-rate mortgages due to the difference in how the interest rate differential is calculated. This penalty can be the difference between roughly 0.5% of the mortgage balance with a monoline lender to as high as around 4% with a bank.

"B" Lenders

These are large, regulated financial institutions. However, they have names that you may not recognize such as: Home Trust, Equitable Bank, Haventree, etc. These companies can only be accessed through a mortgage broker that deals with alternative lenders. These lenders are willing to take on more risk, but in return, they charge higher rates and require higher equity in the property for security. These lenders will offset any issues with credit or income. They are a great solution to open up options when no other lender will provide financing.

Details

Down Payment:	Minimum of 20%
Rates:	Typically, 2%+ higher than “A” lenders
Lender Fee:	1%-2% of the mortgage amount
Terms:	Typically 1 year (2-3 year options are also available)
Amortizations:	30 years (reduce payments to offset higher interest)
Credit Score:	All credit scores accepted
Location:	Reserved for relatively urban areas

Private Lenders

A private lender is either an institutional or individual lender of last resort. They fill the gap in the market for individuals who cannot qualify through A or B lenders. They typically help clients who may have trouble verifying income, very bad credit, or who have properties located in more rural areas. The financing solutions they provide are typically short term at one-year or less. They offer first- and second-position mortgages. A second-position mortgage is one that goes behind an existing first-position mortgage. This can be useful for short-term financing, such as paying off CRA debt, or when the penalty is very large for breaking the existing first-position mortgage. They offer a low-document and common sense-based lending solution.

Details

Down Payment:	Minimum 20%
Rates:	Typically between 7%-15% depending on location
Lender Fee:	Sliding scale, typically a minimum of $2,000 to as low as 4%
Terms:	Typically 1 year
Amortizations:	Not applicable—interest-only payments are made
Credit Score:	All credit scores accepted
Location:	Any location, more rural will reduce the loan to value

Private and alternative lenders strive to provide one-year terms. The reason for this is that they don't want you to be with them forever. They use a one-year term so that you are able to improve your situation. Then, at the end of the term, you can try to exit to an improved lender for a longer-term solution at a much more favourable rate.

Credit

Credit is one of the most important aspects when it comes to a mortgage, and it's also one of the hardest things to change quickly. When it comes to credit, there are two important aspects that lenders look at: credit score and credit history. Even if you have a strong credit score, if you lack the minimum credit history requirements, you could be declined for a mortgage.

CREDIT SCORE

The majority of lenders use a FICO credit score from Equifax. A common question that I get asked is: *"Why is this score different to the score I obtained?"* That's because there are multiple credit scores on a credit bureau. When you do a personal Equifax check you will see your ERS 2.0 score, when a professional (hard check) score is obtained it is the FICO score. The scores are calculated using different algorithms, but at the end of the day, the FICO is the one that is used. Another reason for the confusion is that there are two major credit reporting agencies in Canada, TransUnion and Equifax. Mortgage lenders just use Equifax so ensure that you are not obtaining a score from TransUnion or it will be incorrect.

If you are unsure of what your credit score is, I suggest that you either purchase a report from Equifax or obtain a free copy from a site such as www.Borrowell.com. These personal scores tend to be accurate to within 50 points of your official FICO score.

680+

This will give you access to almost every lender in the market. You will also be able to qualify for more money as the debt servicing ratios can be extended (GDS and TDS ratios will be at 39% and 44%, respectively).

650+

This is the minimum credit score if you want to do a $0-down mortgage or borrow the funds from a line of credit or credit card for a down payment. The GDS and TDS ratios are reduced to 35% and 42%, respectively.

600+

This is the minimum credit score for a 5% down payment. The ratios would be 35% for the GDS and 42% for the TDS in this scenario.

500+

In this category, a down payment of at least 20% will be required and you will have to use an alternative lender, possibly even a private lender.

<500

If you are in this category, you can expect down payments as high as 35% through either a private lender or an alternative lender.

How To Quickly Improve Your Credit Score

One of the quickest ways to improve your credit score is to decrease utilization. What is utilization? It is the percentage of your credit line that is currently being used, and a lower utilization is always better. For example, if your credit card has a limit of $1,000 and you currently have a balance of $900, then your utilization would be 90%, as you have used almost all of your available credit. Utilization is essential when it comes to revolving credit lines. These are products like credit cards and lines of credit that can be actively drawn down and paid back at any time. It is not as important with products such as loans that have one high starting balance that is paid over time.

Roughly 35% of your credit score is calculated from utilization. As soon as your credit lines are more than 50% utilized, they strongly begin to negatively affect your score. If you are currently over your limit on any credit lines, this will dramatically reduce your credit score.

Reducing utilization is by far the quickest way to increase your credit score. I have seen scores increase by over 100 points just from reducing utilization. Start by paying down any over-limit credit lines first, followed by paying down the next highest utilized debt. Try to pay each one down to 50% or less of the limit for maximum effectiveness. If you can pay them down below 50% or even down to $0, this will help improve your score even more. However, it is important to try to evenly apply this across all credit lines. If you have one credit line that is 90% utilized and another that is at only 10%, this strategy will be ineffective. Instead, it would be more beneficial to have them both at 50% instead.

It can typically take up to 45 days to see these changes reflected on your credit bureau. The time it takes depends on where you are in your credit reporting cycle. Here's how that cycle looks:

<u>“Please pay by” date</u>

Ensure that you make a payment by this deadline. Any payment that is made by this date will be on your statement, which will come out five business days later.

<u>Statement date</u>

This is the date you receive your monthly statement for your credit line. Once this statement is issued, this balance will be updated on your credit bureau five days later.

For example, let’s say today is Monday the 2^{nd} and you currently have a balance of $300 on your credit card. Your “please pay by” date for your credit card is today, so you make a $200 payment to bring your balance to $100. Five business days later, on the 9^{th} (the following Monday), your statement is then released for your credit card. This shows the new balance of $100 on the statement, reflecting the payment you made on the 2^{nd}. Five business days after this, on the 16^{th} (again the following Monday), your credit bureau will now show a balance of $100 for that credit line.

CREDIT HISTORY

Your credit score isn’t everything. Even if you have a credit score that is above 650, you can still get declined for a mortgage due to your credit history. If you don’t have an established credit history, the lender doesn’t have anything to base their decision on. For established credit, adhere to what I call the “2-2-2 Rule” and you will be safe: 2 credit lines, 2 years of history, with a limit of $2,000 or more on each. If some variation of this can be met, a lender will typically approve an application. For instance, maybe you only have one credit card but it has a limit of $5,000 and you have had it for over two years. If these requirements can't be met, then you will likely be looking at a down payment of at least 20%, as well as higher interest rates through an alternative lender.

Ensure that at least one of your credit lines are a revolving account where you can draw and pay back money on demand, such as a credit card or line of credit. If you are unable to get a credit card by applying to a bank, you will need to get a guaranteed credit card (Capital One offers a guaranteed Mastercard and Home Trust offers a guaranteed Visa). The term "guaranteed" means that you will need to secure the limit of your credit card with a deposit, i.e., a $300 limit is a $300 deposit to the credit company.

Three Pillars to Strong Credit History:

- 2 credit lines
- 2 years of length
- $2,000 limit or more on each

The Different Types of Credit

There are four different categories of credit that report to your bureau: installment, revolving, open, and mortgage. It is ideal to have a good mix of credit to increase your chances of approval.

Revolving Credit

This is the most important type of credit as it demonstrates how well you actively manage credit. This is something that you can draw down and pay back freely, and it has a variable monthly payment amount based on how much is used. No matter what, you should always have one piece of revolving credit that you keep open. Examples of this type of credit are: credit cards and lines of credit.

Instalment

This would also be considered a loan. It's something that has a fixed monthly payment with the inability to draw any new funds off of it. It shows that you are able to make fixed monthly bill payments with larger debts. However, it doesn't show that you are able to actively manage credit like a revolving line. Examples of this type of credit are vehicle loans, student loans, furniture loans, etc.

Open

Open credit is an obligation that is typically paid in full every month. Although these may not demonstrate strong credit management, they tend to be one of the most overlooked. The most common missed payments that I see on a credit bureau are from cell phone accounts. Ensure that you pay your phone bill in full every month or you risk it showing up as a missed payment on your credit bureau. Examples of this type of credit are phone providers, internet service, charge cards, etc.

Mortgage

This type of credit is not necessary to have a great credit score; it is just another line in the overall profile. I have seen individuals who have stellar credit scores without having a mortgage trade line on their bureau. However, the most important thing when you have a mortgage is to never ever miss a payment. One missed payment on a mortgage can prevent you from accessing an "A" level lender for six years until it comes off your credit bureau.

Non-Reporting Items

Some things—like insurance, utilities (hydro/water), some overdraft accounts and other unique items—may not report to your bureau. However, just because something doesn't report to your credit bureau doesn't mean that a collection can't be registered if you default on that provider. For example, if you stop making payments to your hydro company and it goes to collections, even though the power bills themselves didn't show up on the credit bureau, the collections registered against you will.

Notes on Credit

- Only active credit builds your score. Once you close an account, it will remain on your bureau, but it will not be actively building credit. When you close an account, you will see an instant account drop.
- Any marks on your credit will stay on the Equifax credit bureau for six years.
- The two credit reporting agencies that are mainly used in Canada are Equifax and TransUnion. Almost every mortgage lender uses Equifax.
- Ensure that you always have one (ideally two) pieces of revolving credit that you never close (I still have my very first credit card from when I turned 18). That way, no matter what happens, you will always have strong, established credit. When you have a car loan and it is paid off, you lose all of that history you have built up. That is why having something that never gets closed is so crucial.
- Don't make any large credit commitments before or during the house-buying process. Thinking of buying a new car

with a six-year loan? Wait until after you buy your home. There would be nothing worse than having the lender pull a new credit bureau two weeks before closing only to find your new car loan puts the ratios out in such a way that you no longer qualify. The same applies for a car lease, which is inevitably much harder (if not practically impossible) to get out of. The rules for granting credit on a car loan are nowhere near as strict as mortgage lending. Just be patient and wait until after you have secured your new home before you consider any other loans.

- Here is a question that I am frequently asked: *"I have a score of 750 and make $30k per year, but my partner has a score of 580 and makes $80k a year. Can we average our credit scores as my partner makes more income but I have the better credit?"* The short answer is no, because each borrower must qualify individually. A credit score cannot be averaged, and each applicant must have the minimum credit score required. If both applicants have acceptable credit scores, then both of their debts and income can be grouped together to help qualify.

A Word of Caution – Consolidaton Loan

Consolidation loan – Be very careful when doing these! I have seen clients literally destroy their credit score due to a consolidation loan that was so highly recommended by their bank adviser. Based on what you know about credit now, think about what would happen if you took all of your long-established credit lines and closed them to open a new account. If you guessed your credit score would drop dramatically, then you are correct! Anything that will get rid of established accounts will impact your score.

UNIQUE CREDIT SITUATIONS

New to Canada

The "New to Canada" program understands that people who have recently moved here may not be able to meet the minimum credit requirements in place for traditional citizens. You can qualify with as little as 5% down if you have a proven 12-month history of satisfactory rent payments and another source of payment history, such as a telephone bill, utilities or insurance. They will also accept an international credit bureau (if it exists) from your native country if that country has an Equifax or TransUnion credit reporting agency. If sufficient credit history has not been established, then with as little as 10% down, they will accept six months worth of Canadian bank statements showing satisfactory bill payments.

Bankruptcy / Consumer Proposal

If you have gone through a bankruptcy or consumer proposal, you can still qualify for a mortgage with as little as 5% down within a relatively short period of time.

5% Down Payment

In order to qualify for a 5% down payment, you will need to be two years past the discharge date and you will need to adhere to the 2-2-2 Rule for established credit. You must also ensure that you have not had any missed payments after bankruptcy/proposal as this will be a deal-killer (in the bank's eyes, you didn't learn your lesson). If you have missed payments, you will need to wait six years past the discharge date for a bankruptcy or three years after the discharge date for a consumer proposal. This is when those items will come off your bureau.

20% down

If you have not satisfied the criteria above, you will be looking at putting down at least 20%— possibly as high as 35%—and you may have to go through an alternative lender.

Double Bankruptcy

If you have had a double bankruptcy, then you will need to put 20% down or wait 14 years after the discharge date, which is when it comes off your credit bureau.

House Included In Bankruptcy

If a house was included in the bankruptcy, you can still put as little as 5% down. However, potential lenders will scrutinize it on a much higher level. More could be required of you, such as a longer waiting period or credit lines that have been established for much longer. This type of situation is dealt with on a case-by-case basis, encompassing all factors of the transaction.

Collections / Late Payments

Any accounts that have gone to collections or are in default and closed by the credit guarantor must be paid in full before a mortgage can be funded. Collections and missed payments will stay on your credit bureau for six years after they occur.

Missed Mortgage Payments

If you have a mortgage or have had one in the past, missed mortgage payments are a huge red flag for "A" lenders. If you have a missed mortgage payment in the last six years and it appears on your credit bureau, you will be unable to get a mortgage through an "A" lender. Instead, you will need to go through an alternative lender. I haven't seen an exception made on this to date, even for those with stellar credit scores.

Foreclosure

If you own a home and it went into foreclosure, it can be a challenge to get another mortgage. This is something that is dealt with on a case-by-case basis as it takes into account an array of factors.

Income and Debt

Income is another important pillar of your mortgage application. As the trend for millennials continues to shift toward self-employment, it is becoming increasingly difficult to qualify under the regulated standards.

A Note About Mortgage Default Insurance

As we know, any mortgage with less than a 20% down payment requires mortgage default insurance. In order to qualify for this insurance, you must meet their requirements when it comes to debt servicing, which comes in two forms: TDS (total debt servicing) and GDS (gross debt servicing). These are explained in more detail in this chapter. If you are unable to meet these requirements, you will not qualify for a mortgage. That particular rule is set in stone. The only way to get around this is with a 20% down payment, and you will likely need to go through an alternative lender.

DIFFERENT TYPES OF INCOME

The income used for qualifying is always your gross income, before tax and any other deductions. Unless you are self-employed, which will be explained in this section.

Salary or Hourly with Guaranteed Hours

Salaried income is one of the easiest income methods used to qualify for a mortgage. For hourly employment, income is calculated by taking your "guaranteed" number of hours each work week and multiplying this number by your hourly rate.

The word "guaranteed" is a very important one to understand. Your letter of employment must state that you are guaranteed X number of hours per week. Any other words, such as "typically", "generally", "averages", or the inability to get the word "guaranteed" in writing, will be treated as non-guaranteed hours, which will be covered next.

Letter of employment

An employment letter needs to state the following: Your start date, job title, annual salary or "guaranteed" hours per week and at what hourly rate, and whether you are a full-time or part-time employee. It must be on company letterhead and signed by the employer and dated within the last 30 days.

If you receive substantial overtime or bonuses, these may be included by taking an average of your two most recent years' T4s with the same employer. You can use the greater of your guaranteed income/salary or your two-year average of these T4s. Other perks may also be used, such as a car allowance, but only as long as it's not a requirement of the job and it is taxable income.

Documents the lender will typically ask for:

- Letter of employment, stating your guaranteed hours per week or your base salary and that you are not on probation. This letter must be dated within 30 days and should not be confused with your original employment contract.
- Your two most recent paystubs.
- Optional – Two most recent T4s if an average of your income is to be used.

Hourly with Non-Guaranteed Hours

Hourly compensation with non-guaranteed hours can be used to qualify for a mortgage, but this falls into the category of irregular or fluctuating income. In order to use this income for your mortgage application, a two-year average of your most recent T4s will be used to calculate what your income is. If you are not able to get a job letter stating that you are guaranteed hours, then you will have to use this method. Your two most recent T4s must be from the same employer in order to be used. In some unique cases, an exception may be granted if you were in the exact same line of work but changed employers during your two most recent tax years.

Documents the lender will typically ask for:

- Letter of employment – stating you hourly rate along with the fact that you are a current employee and not on probation.
- Your two most recent paystubs.
- Your two most recent T4s with the same employer.

Hourly + Commissions

This applies to people who are generally in a sales position or who are working in the hospitality industry. This is income that is derived from hourly work but has a variable component, such as some sort of commission or gratuities. This also applies to individuals receiving income on a 100% commission basis. To determine your qualifying income, two years of previous tax returns will be required, and the qualifying annual income will be the average of these previous two tax returns. If the commissions or gratuities are not shown on the tax return, they will not be included in the income calculation.

The income calculation in this scenario can differ depending on how you are paid. If you are paid as an employee with deductions and taxes taken off your paycheque, then you can take a two-year average from your T4s. However, in some cases, one may fall into the category of an independent contractor. Typically, when income has no deductions and you are required to remit taxes to CRA yourself, you are classified as independent contractor. You would also receive a variation of a T4, such as a T4A. If this is the case, you will actually be considered self-employed as you will have write offs and expenses on your taxes. You will need to go down to the self-employed category to calculate your income instead.

Documents the lender will typically ask for:

- Letter of employment, stating you are a current employee and that you are not on probation.
- Your two most recent paystubs.
- Your two most recent T4s with the same employer.

Seasonal Employment / EI

If you are employed seasonally, you can use your income along with your Employment Insurance payments as your qualifying income. In order to prove your income, the last two years of T4s will be required for the seasonal employment and T4Es for the EI payments. The lender will accept a two-year average of both your seasonal employment and your EI payments to calculate your income.

Documents the lender will typically ask for:

- Letter of employment, stating you are a current employee and that you are not on probation.

- Your two most recent paystubs.
- Your two most recent T4s with the same employer.
- Your two most recent T4Es showing consistent EI (if applicable)

A Note on Two-Year Averages

There are restrictions on taking a two-year average of income that may cause the qualifying income to vary.

1. The income has increased by over 25% from the previous year. Typically, an exception will be needed for this increase in income. Otherwise, the most you can use for the two-year average is last year's income + 25%.
2. The income in your most recent tax year is lower than the one prior. In this case, a two-year average will not be taken, and your income will need to qualify using just the most recent year's income. Exceptions may be made due to unforeseen circumstances, such as Covid-19.

Self-Employed

Self-employed income verification almost needs a chapter of its own due to the growing demand and complexity of how it is structured. This is where a good broker comes in, as they can help you to navigate all of the different lenders' policies to help get you approved. There are currently three different programs for self-employed individuals: the standard two-year average model, insured stated income, and alternative stated income. As the number of people engaged in self-employment continues to grow, verifying income continues to be one of the largest challenges faced in the approval process. Each of the three different verification methods are explained in more below.

Important Tip

Your income taxes must be paid in full before a lender will proceed with mortgage approval. The lender will either want to ensure all taxes are paid up prior or you have the resources to do so before applying.

<u>Traditional Method</u>

This method is comprised of taking an average of your two most recent years' tax returns for your self-employed income. This figure is typically located on line 150 (net income) of your T1 General (if you are paid through multiple income sources during the year you will need to isolate the net business income instead of using line 150). The income for the application is found by adding together the two previous years' line 150 figures and then dividing that total by two. Some lenders will actually be able to gross up this amount by 15% as well.

The income each year must be paid in a similar fashion. For example, if you were a sole proprietor and transitioned into a corporation paying yourself a dividend/salary, you will likely need to wait another year to have a matching tax return.

A Note on Two-Year Averages Again

In case you missed this in the previous section here it is again, along with some examples.

1. Your most recent tax year is less than your previous tax year's income. In this case, they will take the lower amount from the most recent year. For instance, in 2019, your line 150 was $57,000, but in 2020, it was $43,000. Since your income declined, the two-year average will no longer apply. Instead, the amount of $43,000 will be used as your income in the application.

2. Year over year income exceeds 25% growth. If your income has grown substantially from the year before, then a reduced amount of income will be calculated. The maximum year-on-year increase that can be used is typically 25% (in some cases, with some lenders, there may be exceptions to this rule). Say, for instance, in 2019, your net income was $100,000. In 2020, it had grown to $200,000. Instead of taking a straight two-year average to arrive at $150,000, you would instead take a 25% increase of 2019's income to arrive at the amount to be used for 2020's income. So, in this case, you would take $100,000 X 1.25, which equals $125,000. Then you would take $100,000 + $125,000 = $225,000 and divide it by two. Your total income to be used would then be $112,500.

Qualifications

Minimum Down Payment: 5%

Interest Rates: A level – best in the market

Minimum Credit Score: 600+

Lender Fee: N/A

Mortgage Default Insurance Premium: As outlined on a sliding scale for any mortgages with less than a 20% down payment. Not applicable for mortgages with a down payment of 20%+.

Documents the lender will ask for:

- Your two most recent years of T1 General Tax Returns.
- Your two most recent years of Notice of Assessments.

Insured Stated Income

This program has some general guidelines; however, qualifying is assessed on a case-by-case basis. The two main factors are: you need to have been in business for at least two years and commission-only income is ineligible. Strong credit is a must for this program, so 680 is typically the minimum credit score required for this product. The stated income must be reasonable given the industry that you are in and they may compare this with income from your most recent year's tax assessment. If you only had a net income of $10k and are stating that you made $150k, it is going to be highly unlikely that you will pass the reasonability test.

Qualifications

Minimum Down Payment: 10%

Interest Rates: A level – best in the market

Minimum Credit Score: 680 (case by case for scores below this, absolute minimum is 600)

Lender Fee: N/A

Mortgage Default Insurance Premium: This product has an increased insurance premium, see the chart below for reference.

Loan to value

up to 65%: 1.50%

65.01% - 75%: 2.60%

75.01% - 80%: 3.30%

80.01% - 85%: 3.75%

85.01% - 90%: 5.85%

Documents the lender will ask for:

Two years' proof of business establishment via either two years' tax returns, business licence, GST/HST return, articles of incorporation, or audited financial statements by a chartered accountant.

Most recent notice of assessment (ensuring no taxes are owed to CRA).

Stated income declaration form along with ownership structure.

<u>Alternative Stated Income</u>

This is the most flexible product in terms of mortgage lending and one that requires no tax returns. This product is provided through an alternative lender and the income reasonability is based on the deposits to your bank account. For instance, if you had deposits of $300k a year going into your account, you could reasonably state that your income was in this range. Your expenses will also need to be reasonable relative to the industry. This program requires a higher down payment and will fetch higher interest rates. Credit score is not an issue as they will accept anyone with a score below 600; however, rates are directly tied to the strength of your credit.

Qualifications

Minimum Down Payment: 20%

Interest Rates: B Level – approximately 1.5%-3% higher than "A" rates

Minimum Credit Score: All credit scores accepted

Lender Fee: 1%-2% of the mortgage amount

Mortgage Default Insurance Premium: N/A - uninsured

Documents the lender will ask for:

- Three- to six-month history of bank deposits to support stated income.
- Articles of incorporation/business licence.
- Stated income declaration, including a statement of whether taxes are paid or not to CRA (taxes don't necessarily need to be paid in full before proceeding with this product)

INCOME VARIATIONS

Maternity Leave

If you or your partner is currently on maternity leave, their full income could be used to qualify for the mortgage. As long as you are returning to work within 12 months to your same employer and can a get a letter from them stating this, then your full income can be used (base salary or guaranteed hours per week applies, this does not work for any sort of overtime/ bonuses you may receive). If you are not returning to work at the end of your maternity leave, will not be able to use any of the income you are currently receiving while on maternity leave as it is not guaranteed into the future.

Probationary Period

Typically, when you start at a new job, you are subject to a probationary period. Can you get a mortgage while in this probation period? Yes. However, the lender will want your closing date to be two days after the probation period ends. They will generally call your employer before closing to ensure you are still working there. This would allow you to make an offer and get approved for financing, but the closing date must fall after the period.

Example

Today is January 1st. You make an offer on a home and it is accepted. It has a condition of financing date of January 10th and a closing date of March 30th. Your probation period at work ends on March 28th. You are able to satisfy the approval of financing date on January the 10th; however, the lender will call your employer on March 28th before the closing to ensure you are still approved. Nerve wracking, right? It's one of the most important jobs you've ever had!

Now there are exceptions to this on both ends of the spectrum. If you have been in the industry for a sustained period of time (3+ years) and you are just switching over to a new employer, an exception may be granted. If you are on a probation period for your first job in a brand-new industry, then the lender is going to want some strength in your assets and income to offset the risks, even after the probation period.

Term Contracts

Term employment contracts are dealt with on a case-by-case basis. If you have been on a term contract with a two-year history through the same employer, you shouldn't have any issues. It becomes a more challenging prospect, however, when you have just started on your first term of a year or less. This is one of those situations where it really depends on factors like how long you have been in the industry, the nature of the company you are working for (are you working for the government?), and whether you have taken EI in the past couple years due to unemployment with this type of work. It is possible to get approved on the first year of a term, but it is on an exception basis.

Relocation

A common situation that I run into arises when clients are moving to a new city and want to purchase a home as soon as they arrive. If you are being transferred internally through the same company or through a government agency (i.e., health care, military, etc.), a job letter confirming your new employment details will generally be sufficient for approval. However, if you are quitting your existing job and starting a new one when you arrive, this typically won't work. The biggest issue is that you will usually be on probation and unable to provide a pay stub proving that you are actually employed there. Even if you are staying in the same industry, the approval can still be a challenge due to the fact that different provinces have different pay scales for the same type of work.

Other issues arise when someone wants to buy a property in a different province than the one they work in (for example, individuals in the oil and gas industry commuting between Alberta and Atlantic Canada). Generally, this is not an issue for qualifying purposes, as long as it can be proven that you are able to work in a different location than where you live. Also, if you are able to work from home, then location is irrelevant.

ADDITIONAL SOURCES OF INCOME

Child Care Benefit (Child Tax)

There are a mix of lenders who will count Child Care Benefit as income. Generally speaking, as long as it doesn't constitute more than 25% of your total income, it can be used. So, for example, if your total income was $40,000, no more than $10,000 of that income can come from CCB.

Child Support / Spousal Support

Child Support or Spousal Support can be used as income. However, the lender will typically ask for not only a separation agreement but also a three-month history of bank statements showing that you are actually getting paid this amount. If your ex is in arrears to the Bank of You, then the lender usually won't count this as income until it has been remediated.

Retirement Income

Retirement income is actually a very important point for millennials to consider as we often have retired parents. Even though they are retired, they can still use that income to co-sign with you on a mortgage if needed. Retirement income can be used for mortgage qualifying purposes. All types can be used, including CPP, OAS, long-term disability and company pensions.

RIF

Funds that are drawn from a Retirement Income Fund can be used. They need to have been drawn consistently for two years, and an average of the two most recent years of T slips will be used.

Other Sources Of Income

There are a wide variety of other not-so-common sources of income that we won't go into detail with here. If you have another source that is not listed above, then it is best to have a direct discussion with a mortgage professional to get a better understanding of whether it can be used or not.

DEBT

Debt is another major component of the mortgage approval process. Different categories of debt have a different impact on the calculation of your debt-servicing ratios. Before we get into the ratios, let's take a brief look at the breakdown of how those items are calculated.

Monthly debt obligations

- **Credit Card:** Take 3% of the total outstanding balance
- **Line of Credit:** Take 3% of the total outstanding balance
- **Student Loan:** Take 3% of the outstanding balance or the current monthly payments, whichever is greater (Some lenders—through a broker—will accept 1%, which can help you qualify for significantly more)
- **Car or Other Loans:** Enter the monthly payment; if bi-weekly, multiply by 26 and divide by 12
- **Collections/Income Tax Outstanding:** These items must be paid in full before a mortgage will be granted

Note:

These calculations will likely differ from the actual payments. However, the above model is used in mortgage qualifying.

Common Misconception

All too often, I get the question: "Can I wrap my debt into the mortgage when purchasing a home?" The short answer to this is: no. Once upon a time, this may have been possible, but not under today's rules. The only time you can wrap debt into a mortgage is when you own a home. In that case, you can do a refinance up to 80% of the home's value. For example, you own a home worth $100k and you currently have a mortgage of $70k on it. At this time, we would be able to say that your mortgage is at 70% loan to value, $70k (mortgage) / $100k (house value) = 70% loan to value. Let's say you have a car loan of $5k that you would also like to roll into the mortgage. So, you do a refinance for a new mortgage of $75k that will pay off your existing mortgage of $70k and your car loan of $5k. We can see if this possible with the loan to value using the formula $75k/$100k = 75% loan to value. So in this case, yes, this would be acceptable. In another example, if the car loan was $15k, then we would need a new mortgage of $85k. When we use the formula $85k/$100k = 85% loan to value, it's easy to see that this is not possible as we would be exceeding the 80% LTV maximum.

DEBT-SERVICING RATIOS (THE INNER WORKINGS OF A MORTGAGE CALCULATOR)

There are two debt-servicing ratios that must be in line when it comes to a mortgage. One is called the GDS (gross debt-servicing ratio) and the other is the TDS (total debt-servicing ratio). A mortgage calculator can figure out these numbers, but it is really good to understand how they are calculated. If you use a mortgage affordability calculator, it will only present what you can qualify for but not tell you how to qualify for more. However, if you know the workings of these calculations, you will be able to understand the reasons why you can only qualify for so much and you can figure out how to qualify for more if necessary. If math isn't your forte or you want to take the easier approach, just do a pre-approval with a knowledgeable mortgage broker, they should be able to present all of the options and strategies.

GDS

This ratio calculates your income versus the debt-servicing obligation of just the mortgage. This doesn't take into account any of your other debt obligations—that is for the TDS ratio. If your credit score is above 680, then the maximum ratio for the GDS is 39%. If your score is between 600 and 680, then the maximum GDS is 35%. The ratio takes into account the mortgage payments at the qualifying (stress test) rate with applicable amortization, plus the property taxes and heat cost divided by your total income.

Example

Sally earns a salary of $40,000 per year with a credit score of 700. She is looking to obtain a $100,000 mortgage. Is her income enough to support this?

Monthly Mortgage Payments

(based on $100k at 5.19% with 25-Year Am):	$592
Annual Figure ($592 * 12):	**$7,104**
Annual Property Taxes:	**$1,500**
Monthly Heat Cost:	$100
(As an annual figure $100 *12)	**$1,200**

Annual Salary: **$40,000**

All the amounts entered need to be for the same time period. This could be calculated using monthly figures as long as all of them are in that format. For this example, we will use annualized figures. All monthly figures were multiplied by 12 to find the annual amount.

Here is the formula:

GDS= (Mortgage Payments + Property Tax + Heat) / Income

($7,104 + $1,500 + $1,200) / $40,000

$9,804 / $40,000

GDS = 24.51%

So, in this example, Sally would qualify as she has a GDS of 24.51%. Since the maximum ratio is 39%, she would be able to qualify for a mortgage beyond $100k if necessary.

Also, there is a variance of this for condos and mobile homes. With condos, you need to add in 50% of the condo fees for the debt-servicing ratios. With mobile homes, you need to add 100% of the lot fees. So, it would look like this:

GDS=(Mortgage Payments + Property Tax + Heat + ((50% * Condo Fees) or Lot Fees) / Income

TDS

Next is the TDS or total debt-servicing ratio. This takes into account all debts and cannot exceed 44% of total income for people with scores above 680 and 42% for scores between 600 and 679. The TDS is very similar to the GDS, except it adds in your debt obligations to the calculation. Here is the formula:

TDS=(Mortgage Payments + Property Tax + Heat + Debt Payments) / Income

So, let's start off with the previous example we used. This time, however, we are going to take monthly figures for the ratios—how well did you do in math?

Monthly Mortgage Payments

(based on $100k at 5.19% with 25-Year Am):	**$592**
Annual Property Taxes:	$1,500
Monthly Figure ($1,500/12)	**$125**
Monthly Heat Cost	**$100**
Annual Salary:	$40,000
As a monthly figure ($40,000/12)	**$3,333.33**

TDS=(Mortgage Payments + Property Tax + Heat + Debt Payments) / Income

TDS=($592 + $125 + $100 + **?**) / $3,333.33

Debts

Sally has the following debts listed below. You can refer to our previous explanation of how these are calculated.

	Limit	Owing	Monthly Paym. Reported	**Paym. Used**
Credit Card	$4,000	$2,000	$20	**$60**
Line of Credit	$10,000	$1,000	$15	**$30**
Student Loan	$15,000	$15,000	$150	**$450***
Car Loan	N/A	$10,000	$475	**$475**

Total monthly debt obligation for ratios: **$1,015**

*Some lenders will allow you to use 1% of the balance, or $150 in this example. As you can see, that will make a huge difference in the debt obligations.

Going back to the formula, we have these figures:

TDS=(Mortgage Payments + Property Tax + Heat + Debt Payments) / Income

TDS=($592 + $125 + $100 + **$1,105**) / $3,333.33

TDS=57.6%

As you can see from this example, the TDS is way over the acceptable limits to get approved. So, if this is the case, how do we get the numbers back in line? Typically, when the TDS ratios are out but the GDS ratios are in line, the best thing to do is look to condition debts that can be paid down. The way that works is once a commitment is issued, it will have a condition that this debt must be paid down before financing will be approved. Often, the lender will not make you close these credit lines so they can still be accessed in the future. So, for example, if the condition is to pay your credit card to $0, you will still have access to your credit limit after the mortgage funds. Some lenders may also want to see where the funds came from to pay down these debts if you don't have enough in savings. Other lenders will be fine with just seeing a printout from online banking showing the balance is currently at $0 or whatever amount they have requested.

You want to try to find debts that have the highest monthly debt obligations relative to the amount it would take to pay them off. We know that our credit cards and lines of credit need to be calculated at 3%, so any balance that has a higher payment than 3% should be eliminated first to get the best bang for our buck. Take a look at the car loan in this example. The payments are $475 on a $10,000 loan. When we divide $475 into $10,000, we realize that this is 4.75% of the amount owing, meaning it should be paid first if possible. Other factors do come into play here though, maybe you have a lower interest rate on that car loan? Or if you pay the car loan off you can't access those funds again in the future.

In our previous example, if we took the car loan out of the equation, then it would reduce our monthly debt obligation of $1,105 by $475 to equal an amount of $630. Let's run the formula again with that figure:

(Mortgage Payments + Property Tax + Heat + Debt Payments) / Income

($592 + $125 + $100 + **$630**) / $3,333.33 = 43.4% TDS

So, by paying off the car loan, we were able to get the ratios in line for Sally who has a score of 680+.

If all of this looks like a foreign language to you, that's ok! Everyone has their strong points. Math is my thing, interior decorating is not, so find your strong suit and ask others for assistance. The idea here is to give the brave an advanced explanation of how these ratios work. It is good idea to at least have a basic understanding of how these calculations work so you can better understand the pre-approval process. However, for the complexities of figuring this all out for a true pre-approval, please rely on a mortgage broker for assistance.

Down Payment

A down payment is always required when purchasing a home. In Canada, the minimum down payment required is currently 5%. The down payment can be saved from your own resources, gifted from family or borrowed. You may have heard about $0-down mortgages—and yes, they really do exist. Since a down payment is always required, a $0-down mortgage is a form of a borrowed down payment mortgage. Sometimes the lender will pay back the borrowed portion for you and sometimes you will need to pay it back yourself. We will go into that in further detail in this chapter.

Traditional Down Payment

For a traditional down payment, you need to have at least a 5% down payment saved from your own resources. These funds need to be verifiable to comply with the ever-increasing strictness of the government's AML (Anti-Money Laundering) policies. In order for funds to be verifiable, they either need to be in your bank account for at least 90 days or you will need to prove where the deposit came from. For instance, if you have been accumulating your employment income from direct deposits through your employer, then it would be easy to verify where the funds originated as it is coded from your employer on the bank statements. However, if you have been depositing cash into your account, then this would not be verifiable as you can't prove where those funds came from. Say you deposited $10k cash into your account 60 days ago from the sale of a motorcycle that you have no record of. These funds could not be verified for use in the down payment. You would need to wait 90 days to use these funds for a down payment. Essentially, if it can't be traced or isn't coded from a traceable source on your bank statements, it needs to be in your account for 90 days.

Gifted Down Payment

A gifted down payment can come from an immediate family member (mother, father, brother, or sister). It can't come from your long-lost cousin Steve or your best friend from childhood Gus. Once the mortgage is approved, you will have your family member fill out the gift letter for that specific lender. Then, you just need to show the deposit into your account for the exact amount on the gift letter. Typically, just the gift letter and the proof of the deposit into the account is all the lender will require to verify this down payment. There are other ways to verify the gift without showing the deposit as well but these are lender specific. Sometimes the person providing the gift can take the letter into their bank to have it stamped and verified that they have the funds or a lender may accept a statement from their account showing they have the funds available.

Tip

Don't forget about the "closing costs" as well! No matter what down payment option you are using, the lender always wants to see that you have enough funds for the deed transfer tax. This is especially true with borrowed or gifted down payment options. This tax rate varies not only from province to province but within different municipalities as well. In Halifax, for example, the deed transfer tax is 1.50% of the purchase price.

Borrowed Down Payment

You can also borrow the funds from your own resources. This means that if you don't have the down payment, but you have access to it on a credit line (i.e., credit card, line of credit), you can borrow the funds for this transaction. However, one thing to keep in mind is that the mortgage default insurance premium will increase by 0.50% to 4.50% due to the increased risk associated with this. I would only suggest this as a method of last resort for disciplined individuals who can stick to a strict budget of paying back their credit line. Also, a strong credit score will be required to take advantage of this program, which is called "flex down". One more thing to understand is that it will reduce the amount you can qualify for as the borrowed funds need to be factored into the TDS ratios. If you were to borrow $10k for the down payment from a credit line then you would need to factor in a $300 monthly debt obligation for your TDS calculation.

$0-Down Mortgage

The $0-down mortgage is a product that is provided on a provincial level, not on a national level. I am going to provide some insight into the programs that are currently available in Nova Scotia. If you live in another province, you should call a local broker to see what programs are available in your area or reach out to me so I can connect you with one of my colleagues in your area.

Tip

> Whenever you are using a $0-down product, you will always qualify for less than your pre-approval amount. This is due to the fact that the borrowed portion of the down payment must be put into the debt-servicing ratios.

In Nova Scotia, there are two forms of $0-down mortgage: one is facilitated through a local credit union and the other is provided through the provincial government under the Nova Scotia Down Payment Assistance Program.

Nova Scotia Down Payment Assistance Program

This an interest-free loan for the 5% down payment. This loan is based on a ten-year term and there are no payments required for the first year. This program has its restrictions, such as a maximum household income of $75k per year, the house value cannot exceed $280k, and if you have previously owned a home, you cannot qualify. However, it will still allow you to gain access to the lowest rates in the market for the lenders that participate in this program.

$0-Down Mortgage

A $0-down mortgage provided through a credit union is essentially a 5% "cash-back" mortgage. The lender will initially open a credit line for you to temporarily borrow the 5% down payment. After the mortgage closes, you will receive the 5% cash back and you can decide to either pay off that credit line or keep the cash to use it however you wish. Since the lender is giving you the down payment and not requiring it to be paid back, the interest rate is higher. This is the way they recoup that money over the five-year term. Typically, you can expect rates to be 2%-4% higher than market rates. Currently, that rate is around 5.50% for a five-year fixed term.

For either of these programs, you will need a credit score of at least 650 to qualify.

Minimum Down Payments For Different Types Of Properties

Standard – Owner Occupied

Single Family – 5%

Owner-Occupied Rentals

These are properties that have multiple units, where you intend to live in one unit and rent out the others.

Duplex (2 units) – 5%

Triplex (3 units) – 10%

Fourplex (4 units) – 10%

Rental

To be solely used for rental purposes, where you will not be occupying the property personally

Rental property (1 - 4 units) – 20%

Commercial Mortgage

Any residential property that has more than four units will require a commercial mortgage, even if you plan to live in one of the units.

Properties with more than four units or commercial space, reviewed on a case-by-case basis, are typically 20%-35% down.

First-Time Home Buyers

In this section, we will go over some of the programs available for first-time home buyers. The programs listed below are federal programs that are available across Canada. Inquire with your local mortgage broker for details of all the programs that are available in your province or specific municipality.

5% Down Payment

"A 5% down payment is only for first-time home buyers" – Myth

Contrary to what many people believe, a 5% down payment is not exclusive to first-time home buyers. This down payment is instead reserved for anyone who intends to "owner occupy" a property. It is possible that you can actually buy a second or third property with 5% down if you turn your existing residence into a rental.

RRSP

You are able to use up to $35,000 from your RRSP and a combined $70,000 per couple for the purchase of a home. The funds must be in your account for 90 days before they can be withdrawn under this program. The money is taken from your RRSP "tax free" under the home buyers plan and you have an obligation to pay it back over the next 15 years. If you do not pay it back, the government will begin taxing you on this income. In some cases, you can have owned a home in the past and still qualify under this program. A copy of the form is available on the CRA website that provides additional qualification details.

The process for taking the funds out of the RRSP is quite simple. Once you have an accepted offer on a home, you fill out the form. Once this is complete, you will provide it to the financial institution that holds your RRSP and request that the funds be withdrawn. Typically, the money will come out of your RRSP within one to five business days and will be deposited into the requested bank account.

Shared Equity Program

You may have heard about the shared equity program that was recently launched, as there was a lot of hype about it in the media.

The biggest misconception of this program is that the shared equity program provides you with the down payment—that is not correct. The shared equity program is designed to reduce your monthly mortgage payments and borrowing costs. It will also help reduce your mortgage default insurance premiums as it will allow you to move up one or two premium categories. This is due to the fact the default insurance premium is calculated on a sliding scale.

In Nova Scotia, we are one of the better suited provinces for using this program as the maximum house price for the program is $480k, which is significantly over our average house price.

<u>Here's how it works:</u>

The mortgage default insurer will contribute 5% to 10% of the purchase price towards your home. This reduces the amount you are mortgaging and in turn reduces your monthly mortgage obligations. For newly constructed homes, they will provide a 10% ownership. For existing homes, they will provide a 5%

ownership. When you sell the home, you pay back the equity share at the price you sold it for.

Example

Assume you purchased an older home for $100,000 with 5% down ($5,000) and a 5% equity share ($5,000). That means that the total amount you would be mortgaging is $90,000 (disregard the addition of the mortgage default insurance premium for the simplicity of this example). In ten years' time, you decide to sell your home. It has appreciated significantly, and it sells for $200,000. At this time, you would have to pay back the 5% equity stake, which has now grown to $10,000 as it is 5% of $200,000.

In certain situations, for the right borrower in the right market, this program can be valuable. In other situations, however, it may be a disadvantage. Have a conversation with your broker to see if this program is right for you.

HST Tax Rebate

If you are purchasing a new construction home in Canada, GST/HST will be charged. As a first-time home buyer, you may be eligible for a rebate on the taxes charged. Every province has their own tax rates, so it is recommended that you check with the CRA website to find specific details on the program.

Pre-Approvals

A pre-approval is a great tool and provides a number of benefits. It provides insight into how much you can qualify for, what the monthly payments would be, and whether everything is in order or if additional work needs to be done. However, it does not guarantee an approval when the time comes. Why is that? Well, it's because a pre-approval is based on estimates and reflects a specific period in time. If you withhold crucial information from your broker, such as how much money you actually make or the fact you have to make child support payments, it can derail your full approval once you make an offer on a home. Any changes to your personal situation in regards to credit, assets, or income after your pre-approval can also affect the approval when the time comes. For example, financing a brand-new truck after your pre-approval will change your circumstances and could impede your mortgage approval.

It is important to know the difference between an approval and a pre-approval. A pre-approval is based on estimates using theoretical figures for a property. An approval is for a specific property once an offer is made and is backed up with documentation to prove the information in the application.

I am a firm believer that everyone should get a pre-approval. Without it, you just don't know. It's a great idea to get pre-approved sooner rather than later. If you are thinking about getting pre-approved, just do yourself a favour and set up a quick call or appointment with a mortgage broker. It takes less than an hour to complete. Nothing is worse than getting ready to buy a home only to find out that there are issues that are now going to take a year or two to resolve. A common problem

I've encountered is that clients do not have enough established credit, which can take up to two years to build with a trade line.

With that being said, be honest with your broker and tell them any nuances or irregularities with your situation. Unlike a mortgage specialist at the bank, a broker is here to work on your behalf and with your best interests in mind—not the lender's. They will help ensure that everything is in order so that you can get approved.

120-Day Rate Hold

A pre-approval is also a great tool if you are looking to purchase a home in the next 120 days. This is because your broker can obtain a rate hold through a lender. A rate hold will lock in a rate today, so if the rates go up in the market, you're still entitled to that lower rate as long as the closing date is within that 120-day window. If rates go down, then you can just disregard the rate hold and obtain the new lower rate. It's essentially free insurance for the taking and it comes at no cost to you. Just make sure that your broker is aware that you would like one so they can obtain it for you.

How Much Can You Qualify For? *(A truly accurate mortgage calculator)*

You may have come across some sites with mortgage calculators and been confused as to why they offer different amounts. Some lenders have minimum guidelines as to what amounts must be entered for items like unsecured debts, heat, property taxes and more. I have provided a comprehensive list that will allow you to calculate your maximum mortgage amount with precision.

Note: This does not guarantee that you will be approved for the amount listed below. The guidelines presented are general principles and your exact situation may cause changes in these figures. This is to be used as an estimating tool. It is always recommended that you secure a pre-approval from a mortgage broker before making an offer on a home.

Mortgage Calculator (using monthly figures)

I recommend using the calculator provided by Centum below. I have tested it against my professional software and found it to be very accurate. I have also listed all of the fields below as they directly relate to the specific calculator fields.

https://www.centum.ca/calculators/affordability

Income *(divide by 12 for your monthly income)*

Salary: Use your annual base salary

Hourly: Take your "guaranteed" hours per week multiplied by your hourly rate and then multiply by 52. If your hours aren't guaranteed, you will need to take a two-year average of your T4s with the same employer.

Self-Employed: Take a two-year average of your line 150 net income from your two most recent T1 Generals.

Overtime/Bonus/Seasonal: Take a two-year average of your two most recent T4s with the SAME employer. If this amount is higher than your hourly or salary calculation, you may use it instead.

Government Sources (Child Care Benefit, CPP, OAS): Use the annual figure according to the most recent statement, T4, or multiply the monthly payments by 12.

Interest Rate

This is the Bank of Canada's qualifying rate that will be used. At the time of writing this was currently at a rate of 4.79%. This is not the rate you receive but the rate you must qualify at to satisfy the requirements of the stress test.

Amortization

This cannot exceed 25 years unless you are putting more than 20% down. If you shorten the amortization, you will pay off the mortgage quicker, but it will reduce how much you can qualify for as it will increase the payments.

Heating

$100 per month per unit being purchased will be used for qualifying. So, for instance, if you were looking at buying a triplex, the heat would be $300 per month.

Property Tax

Each municipality has their own specific tax rate. You should be able to find this on your municipality's website. Once you know this figure, multiply the price of the home by the tax rate to get a conservative figure. *In the Halifax Regional Municipality, you can estimate the taxes by multiplying the purchase price by 1.21% (0.0121) to get a conservative amount as it is based on the assessed value not the purchase price. Divide this figure by 12 to find the monthly tax payment for the calculator.*

Condo Fee

This applies to condos or mobile homes on leased land.

Debt payments

Add up all of these calculated items for each debt you have and enter it in the monthly field.

Credit Card: Take 3% of the total outstanding balance

Line of Credit: Take 3% of the total outstanding balance

Student Loan: Take 1% of the outstanding balance or the current monthly payments, whichever is greater

Car or Other Loans: Enter the monthly payment. If bi-weekly, multiply by 26 and divide by 12

Collections/Income Tax Outstanding: These items must be paid in full before a mortgage can close

Using these figures, you should be able to calculate your maximum approval amount with significant accuracy OR you can take the easy way out and you can contact a mortgage broker to complete this process for you.

Increasing Your Approval Amount

If you have done the calculation and you are not satisfied with the amount you qualify for, here are some options to get that amount higher:

- Add a co-signer to increase the overall income on the application (don't forget you will need to add their liabilities and debts into the calculations)
- Reduce the amount of debt you have (you can still make an offer with the debt outstanding if you plan to pay it down, but the lender would condition that these debts will be paid before closing)

- Increase the down payment (once you exceed 20% down, you can go to a 30-year amortization, thus helping you to qualify for even more)
- Purchase a property with a rental income suite (see below)

Income Suite

Having an income suite is a great way to boost the amount you can qualify for when it comes to a mortgage. The additional rental income can be added to your existing income to qualify for more. This calculation is a bit more complex as each lender has different guidelines for rental income.

As a good rule of thumb, if you take the annual rental income and multiply it by 1.5, you should be able to increase your qualifying amount by this figure. So, for example, if your pre-approval amount was $100k and the property has $1,000 per month in rental income, this could increase your pre-approval amount to $118k ($1,000 X 12 = $12,0000 X 1.5 = $18,000).

A well-managed income suite is a great way to reduce your monthly payments. There are a lot of additional costs as a homeowner that may not be apparent as a renter, such as water, repairs, property tax, oil and more. Having a good tenant will assist with paying for these costs and help build up funds for any emergency repairs.

Co-Signers

Adding a co-signer to a mortgage is a great solution to help you qualify for a mortgage if you are unable to on your own. Given that the co-signer brings strength to the application, they can help you qualify for a higher amount or make your application a more attractive prospect if needed. You will apply with the co-signer on the mortgage application and they will need to go on the title of the home, along with the mortgage.

A co-signer needs to be aware that this could affect their ability to get a mortgage in the future. They will be holding this debt jointly with you, so if they want to obtain their own mortgage, they will need to debt service not only their new home but your home as well.

So how long do they have to stay on as a co-signer? It depends on the situation, but I'm happy to offer some insight. There is a reason why you need someone to co-sign, and until that reason is resolved, you will not be able to qualify for a mortgage on your own. So, typically, the amount of time it takes for this to occur is the amount of time the co-signer needs to stay on. If you have bad credit, well, they are on there until it improves. If you don't have enough income, then they are on there until you can qualify on your own.

There are two ways that a co-signer can be taken off a mortgage. The first way is through contacting the existing lender and applying to have them removed. You will have to be re-approved for the mortgage on your own and prove that you can qualify. This is truly a case-by-case scenario as it is at the lenders discretion whether they want to take off the co-signer or not.

Think of this from the lender's perspective. They are taking off the additional safety net on the mortgage while incurring costs to complete this process—and all for no additional benefit to them. You may find yourself faced with many challenges going down this route for this reason. The other option is to do a refinance and take the person off title with a new mortgage. This process is much easier to complete because you are essentially obtaining a new mortgage (typically from a different lender) to pay off an existing one.

I would suggest budgeting for a five-year period for two reasons. Firstly, you are usually on a five-year term with your lender, so when this comes up for renewal, you can do a refinance with no penalty. To do a refinance, you can only go up to 80% of the appraised value of the home. Typically, five years should be enough time to build 20% equity to complete this through appreciation and mortgage paydown. Secondly, this should give you enough time to resolve any of the issues that were initially present when the co-signer was required.

Renewals

Mortgages in Canada are traditionally issued on five-year fixed terms. When the term ends, you will need to decide what course of action to take. Essentially, there are four options: (1) renew with your existing lender, (2) switch to a new lender, (3) refinance to obtain some equity/add or take people off title (4) pay off the mortgage in full/sell. Let's go through each of those options below:

Tip

When you receive your existing lender's renewal offer, always reach out to a mortgage broker to request a free quote on what rates are available. They have access to a wide array of lenders and can look around to see if they can find you a better rate than what your current lender is offering. These lenders will generally cover the costs associated with transferring to them as well. Typically, they can lock in a rate four months prior to your renewal date, so if rates increase in the market, you will be protected.

Renew

As long as you have made all of your mortgage payments on time, the lender will almost always provide you a renewal offer. If you have missed some payments, they still may offer you a renewal but at a higher interest rate. You can typically expect a renewal letter in the mail somewhere between two to six months before your renewal date. If you are one month away from your renewal and you still haven't received a letter in the mail, you should contact your lender ASAP.

So, What Happens If I Don't Renew?

Well, of course, that depends. What happens if you don't provide your renewal intention is actually detailed in your mortgage agreement, and it typically ranges from automatic renewal into a six-month open term or a one-year closed term. Almost always, you can expect your rate and your payment to increase compared to what you are currently paying. It is very important to ensure that you renew so you can align it with your goals.

Let's take a look at an example. Frank was super busy with work and pushed his renewal off until the last minute. He reached out to a mortgage broker and discovered that if he switched to lender X, they would offer him 2.75%. Meanwhile, his existing bank was only offering 3.50%—a big difference. Life gets busy again and the next thing you know, Frank has gone past the renewal date with his existing lender. He starts to panic thinking that the bank is going to foreclose on his house and gives his broker a call right away. She puts him at ease and assures him that the bank is not going to foreclose on the house, which is his top concern at this point. Frank is now motivated to get everything sorted and complete. The broker gets everything approved for the transfer, but when the payout statement is ordered, it turns out that the existing lender has actually renewed Frank into a one-year closed term. This means that Frank can no longer exit his existing lender before the end of this new one-year term without triggering a large penalty. If he had been proactive, he could have at least notified the lender to renew him into an open term so no penalty would have been triggered. Better yet, he could have been approved to switch to a new lender 120 days before his renewal date, so on his expiry date, he could have smoothly transferred to the new lender.

This is a perfect example of how being proactive and not procrastinating can really save a lot of money.

Tip

When you renew with your existing lender, you do not need to requalify or provide any sort of new supporting documentation. So, if you have lost your job or your credit has taken a hit, your lender will most likely still offer you a renewal. If certain aspects of your situation have changed to an extent where you no longer qualify for a comparable mortgage, then you will be stuck with your existing lender. Typically, people's situations change for the better over the term so this is not usually an issue. However, if you are thinking of quitting your job to become a professional YouTuber or you're going out to buy that brand-new truck, try to wait until after your mortgage is renewed so you have more options for better rates.

Switches/Transfers

It tends to be very common that a bank will offer a better rate to their new clients than their existing ones. Most of the monoline lenders that mortgage brokers deal with will offer very competitive renewal rates that are the same rates that a new customer would receive. Since monoline lenders are in the business of mortgages alone, retention is extremely important to them—their business model relies on it.

When you are with a bank lender, most of them will collaterally charge your mortgage. When this happens, it makes it more costly to switch to another lender due to the legal process. If you are with a lender that does not collaterally charge the mortgage, such as a monoline lender, you can typically switch lenders and the new lender will cover all of the legal costs for the transfer. However, under a collateral charge, the legal costs may need to be added into the mortgage or paid for out of pocket.

When transferring to a new lender, you will need to go through the approval process again with a couple documents, such as an updated credit check and documents to support your income.

Refinance

If you have enough equity in your home, you may have the option to do a refinance at renewal without penalty. A refinance can be valuable if you have amassed a high amount of consumer debt and you want to wrap it into the mortgage to reduce the overall interest. It can also be a way to extract equity for other projects, such as renovations or for investments. Just keep in mind that you can only refinance up to 80% of your home's appraised value. Depending on your market, if you purchased a home with 5% down and you just finished your first five-year term, you may not have enough equity to qualify.

Sell/Pay in Full

The other option at renewal is to pay off your mortgage in full or sell the property. If you have the property up for sale and you are concerned that you will surpass the renewal date before the sale, you must inform your existing lender that you want to go into an open-rate mortgage product. This will have a higher interest rate, but it will keep your mortgage open for payment at any time without a penalty. If you fear that your home is going to take quite a bit of time to sell, opt for the variable-rate closed mortgage. This will allow you to break the mortgage at any time with a three-month interest penalty, thus ensuring you keep your costs low.

Purchasing A Rental Property

Purchasing a rental can be a great long-term investment. If you are purchasing a property solely for the purpose of using it as a rental, then you must put 20% down. You do have the ability to purchase a home with less than 20% down if you occupy it and then turn it into a rental later down the road, such as when you decide to buy a new owner occupied property. It is extremely important to note that you should never purchase a property that you are stating you will owner occupy and then immediately use it as a rental. This is considered fraud. If you are caught, the lender has the right to take the necessary actions to resolve this by demanding the mortgage be paid in full immediately or requesting the remaining down payment to reach 20%. However, you can purchase a property that you occupy. Then, in a year's time or so, when you outgrow that property, if you decide to purchase a new one, you can turn your existing home into a rental and purchase another one with less than 20% down. Most lenders do not have an issue with you turning your existing home into a rental after some time, but ensure that you check your specific lender's policies before doing so.

Myth

Many believe that a 5% down payment is only for a first-time home buyer. This is actually false. A 5% down payment is only available to someone who will owner occupy their home. Essentially, a mortgage default insurer will only insure one property that you own (with the exception of Genworth). Since there are only three insurers in Canada, this means that you can purchase up to three properties that you plan to owner occupy with less than 20% down. It may be possible to purchase additional properties after this with less than 20% down, but this would be on a case-by-case basis through Genworth.

Construction Mortgages

A construction mortgage can be a complex task, even for a veteran home buyer, and even more so for a first-time home buyer. There are a lot of moving parts and organization is key. I position myself as an expert for these types of mortgages, and it's an area that I truly enjoy helping with. There are a couple ways to go about getting a construction mortgage. You can either do a self-build or a contractor build. There is also a much easier option to get your own custom turnkey home, which we will also discuss.

Note: Due to the complexity of construction mortgages, each lender has their own set of specific rules. The point of this section is to make general assumptions about how this type of mortgage works. This section relates to the specific lenders of Nova Scotia. The lenders in your area may offer something very similar or different from what I present here. There is also another option that gets around a lot of these rules: using higher interest private financing. Through a larger down payment of 25%-35%, you can get around a lot of the restrictions and obtain the funds to build your home through a private lender. Then, once the house is complete, you can transfer it to a more favourable lender for the long term.

Land/Down Payment

The first thing to remember with a construction mortgage is that you always need to own the land. A lender will not grant you the funds to do a construction mortgage unless you have the land in your name. The land is your down payment in a construction project, but you don't always need to own the land free and clear. There is a way to potentially get around this.

Construction mortgages can be default insured, allowing you to have as little as a 5% down payment in the project. The down payment is calculated using this formula:

Loan to Value = Land Value/(Land Value + Construction Cost).

Let's look at a simple example: you have a land value of $20k and a construction cost of $80k for a home. This means that once the home is built, it would effectively be worth $100k (the value of the land and the house combined). Therefore, with a land value of $20k over a house value of $100k, you would effectively have a 20% down payment in this project 20 / (80 + 20) = 20%. So, in this scenario, if you need to own the land, then how can you put 5% down? This matter gets a bit more complex; however, if you can obtain a loan on the land, you can reduce your overall down payment. Getting a loan on land from a bank can be difficult, but they may be willing to give you 50% of the value or more on marketable properties. You can also look at using private lenders to temporarily provide funds for the acquisition. One of the most favourable ways would be to get a vendor take-back loan on the land. In most areas, land lots do not sell quickly. If you can offer the seller a firm agreement to purchase, but in turn they need to hold back the loan for a few months, they will generally be very willing to help.

Here's how that would look in our example above. Let's say you are buying that piece of land for $20k but you only have $5k. The land owner would sell you the land for $20k, taking your down payment of $5k and holding a vendor take-back loan for the remaining $15k. You would get the title of the land put into your name and then effectively have a loan registered against it for $15k (always ensure that you use a lawyer to legally complete this process). So, going back to our original formula, we add another layer:

Loan to Value = (Land Value – Any Outstanding Loans) / (Land Value + Construction Cost)

5% = (20k - 15k) / (20k + 80k)

In this example, we arrive at a 5% down payment in the entire construction project. What will happen is the holder of the land loan will get paid out during the first draw of the construction financing. As you can see, construction mortgages can be very complex, and we haven't even got past explaining the land! If you are considering this type of mortgage, it is of the utmost importance that you find a broker who is experienced with these types of mortgages. Ask how many they have completed. If it is fewer than five, you will want to proceed with caution or search for someone else. You don't want to share the experience of going through your first construction mortgage with a broker who is also going through it for the first time.

How Land Is Valued

Since land is used as the down payment it is important to understand how it is valued. If you purchased the land with a legal purchase and sale agreement you are generally able to use the value you paid for the property. If you bought it off an immediate family member or already own the land then an appraisal will be required. Sometimes the assessed value can also be used. An appraisal can also be used if it is believed to be worth more than the other methods used.

Areas of Caution

Living Arrangements During Construction

So, you're building a home. But where are you going to live while it is being constructed? If you currently own a property and are living in it while the house is being built, you may run into a challenge as you will need to debt service both your existing property and the property being built at the same time. If this is the case, then you may need to rent your existing home and live in a rental or with family in the meantime, because those options will not affect the ratios.

Shortfalls

One of the most important things when building a home is ensuring you have access to capital. Typically, the first draw is going to be light and you may need to float tens of thousands of dollars to get to the next draw (the reason for this is explained in how it works). Having funds on hand is crucial. Otherwise, you risk not paying your trades/contractor on time and the construction will come to a standstill.

Underages/Overages

There is nothing worse than the feeling of being overbudget and running out of funds during a construction project. It is ideal that you always build in buffer room for unexpected costs and overages. Once the construction project begins, it is not possible to obtain additional funds for a higher mortgage. On the contrary, if you over budget and have additional funds at the end of the project, you can either use them for add-ons that you didn't budget for or your lender will typically have ways to pay this back down on the mortgage.

Draws

Financing a construction project is done through multiple draws. Each lender has their own policy for how many draws can be taken and at what stages. Some lenders are stricter on this and some are more lenient. For the most part, a construction mortgage typically operates off a four-draw cycle. These stages for draws are listed below:

-Pre-backfill (foundation in)

-Framing, roof tight

-Pre-drywall

-Occupancy permit

Self-Built

Lenders for self-built mortgages are becoming scarcer due to the inherent risks that lenders face. With that being said, it is still possible and at a relatively good rate. To be considered for a self-built mortgage, generally, you cannot have one contractor completing more than 50% of the work. You will need to provide the building plans and all the quotes for every item going into the home. A lender-provided worksheet will be given to you to ensure that every item in the home build is accounted for in the quotes. It is very important that everything is accounted for. If you start building your home and run out of money, you will not be able to request more funds from the lender.

Contractor Built

When a home is built through a contractor, the process becomes much simpler. Instead of providing all of the quotes, the lender will simply require a builder's agreement outlining the total cost of the project. An important conversation to have with the contractor is around the new home warranty. Almost every lender will require this on a newly built home. Larger builders will typically be registered with a company; however, smaller ones may not. If they do not have a warranty account, they will need to purchase a one-off package through a company, such as LUX. This can be thousands of dollars, so ensure the builder has included this in their final price. Finding a reputable contractor is another important consideration.

Turnkey

A turnkey purchase is not actually a construction mortgage; however, it is very similar and a much more favourable path if it is possible. Through a turnkey package, you will get a custom-built home matched with the simplicity of a traditional resale home purchase experience.

With a turnkey package, the builder will finance and build the home to completion, and once it is finished, you will purchase it off them for the agreed price. This is typically how new construction homes in new subdivisions are structured. You get to pick out your finishing touches, choose the builder's lot that you want, and then get approved for the mortgage. They finance the build, and when it's complete, the purchase executes and the home (and the mortgage) is yours.

If you are looking to do this on your own lot of land, then the process is very similar. Typically, you can arrange a turnkey purchase with a strong, reputable builder. Smaller builders often can't do this because they don't have access to the level of capital required to bring a home to completion. This is also a risk mitigation for you because if the house doesn't get finished, you're not purchasing it. The handling of the land is the only complexity here. The builder will need to have the land in their name before beginning this project. The reason for this is simple: what builder would want to put themselves at risk floating a project to completion on land they don't own? I think you can see the issues there. If you currently own the land, then you would need to transfer the deed to them. There may be some costs associated with this for the deed transfer tax. However, if the land is up for sale then what will typically happen is the builder will purchase it and you will provide the cost of the land as the down payment for the project.

How It Works

Once you have been approved for financing on your construction mortgage, here is how the process will unfold:

1. You begin construction on the home. You will need to adhere to a timeline specific to the lender. Here are some general rules: the first draw must be taken no later than 120 days from the application date and the final draw must be taken no later than six months after the first draw.
2. *Note: The most important deadline is that first 120 days. This is the amount of time the lender deems your documentation "current". If you miss this deadline, the mortgage will need to be re-approved, including an updated credit bureau and employment verification. There would be nothing worse than getting declined for a mortgage when you have already started the project due to a $20k balance on your line of credit that put the ratios out because you were floating the work. Find out what this date is for your lender and stick to it no matter what—even if you have barely done any work, take that first draw in time. If you go past the deadline for the final draw, that isn't as bad. The lender will typically grant exceptions*

and provide more time if good reasoning is provided. Ensure you discuss what your specific deadlines are with your mortgage broker as they vary from lender to lender.

3. The first draw. You will request the inspection. A bank-provided appraiser will assess the level of work that has been completed. They will determine a percentage of completion and relay this back to the lender. There is almost always a shortfall in the first draw that will be made up in the second draw. However, you may need to float trades or access capital during this time, so be prepared. A good rule of thumb is to have access to 25% of the construction cost of the home either on credit or in cash.
4. You continue taking draws for the second and third phases as they are complete, similar to the first draw.
5. To take the final draw, the house must be 99% complete and have an occupancy permit. After this occurs, the mortgage is finalized, and you go into a regular payment schedule. Typically, during the construction phase, most lenders will require interest-only payments on the amount drawn, which will be a fraction of the standard monthly payments.

Different Property Types

Land Purchases

Land can be difficult to purchase, but it depends on the use of the land. Typically, if the land is under five acres, zoned residentially and over $50k in value, you should be able to get a loan on it. However, due to the difficult marketability of land, lenders will generally only finance 50% of the value and you may need to go through a private lender at higher interest rates. For land plots over five acres or for agricultural purposes, you may need to obtain a loan through specialized lenders, such as the farm board, BDC or commercial lenders.

Commercial Mortgages

This type of mortgage is beyond the scope of this book as it is very unlikely that it would apply to a first-time home buyer. A commercial mortgage is required on anything that isn't a residential home or if it is a residential property that has more than four units. If you're looking at buying a store front or a six-unit apartment complex, then you can expect to go commercial. Commercial mortgages are created on a case-by-case basis, so there really isn't a set of guidelines that can be followed. Don't be expecting to put 5% down on a commercial property (unless under very select special programs). You're typically looking at a minimum of 20% for a high-quality property all the way up to 50% if its higher risk, such as an auto repair shop or gas station. With commercial lending, the interest rates are typically higher and have lending fees. If this is something you are considering, it is in your best interest to talk to a commercial mortgage broker who specializes in this line of work. Some residential brokers, such as myself, will have connections to commercial brokers who can help you.

Mobile / Modular / Mini Homes (Leased Land)

As house prices continue to rise, this type of housing continues to gain popularity for an entry-level home. For this explanation I am addressing a house that is situated on leased land. These types of homes are actually one of the more difficult ones to get approved for. Not only do you have to get approved for the mortgage, you also need to get accepted into the park. The lenders that are willing to do this are getting scarcer due to the risk level (you can move the home) and because of this, you can usually expect higher interest rates.

The main thing to realize is that this will reduce your overall pre-approval amount as the lot fees also need to be factored in. Age is another a major factor in these types of homes, so a lender may decline the financing due to the age of the property. If major renovations have not been carried out in the past five years and the property is more than 20 years old, a lender will likely pass.

Mobile / Modular / Mini Homes (Non-leased Land)

When these types of properties have owned land, they may fall into different categories. I will lay out some very generalized guidelines here. If you have a mobile or modular home on owned land, its classification for financing will depend on how it is secured to the land. If it sits on a pad or blocks, then it will likely fall into the same category of lending as above. However, if it has a true foundation or a basement, then it would be classified as a traditional home. This applies unless the square footage is below 750. If it is below 750, it can be difficult to find financing as lenders impose restrictions on minimum square footage requirements.

Hobby Farms

A hobby farm is one of those case-by-case approvals as well. Typically, lenders do not want to be involved lending residentially for any agricultural purposes. If you have a couple chickens and a goat, it may be acceptable, but if you have more than ten animals and a few barns, it's going to be a challenge. The same also goes for any plots of land that are actively farmed.

Cottages/Second Home

A second home/vacation home can be purchased with as little as 5% down. If it is a standard home that is being used as a cottage, then there wouldn't be any issues. If this is a true cottage, then it can be approved as a type B property, as long as it meets the minimum requirements. The main thing is that it must have a three-piece bathroom and kitchen (sorry, no treehouses!). Seasonal access is acceptable along with no permanent heat source (such as a fireplace or wood stove). The water doesn't need to be potable but there must be running water and plumbing.

Different Types of Mortgages

There is a wide array of mortgages out there to suit different needs. In this chapter, we will go into further detail to explain how each of these work.

Purchase + Improvements

This is one of the most requested and often misunderstood mortgage products out there. A purchase plus improvements mortgage allows you to obtain funds for renovations on the home. This works great for a home that is dated or needs some repairs. Here are the main requirements of the program:

- Renovations cannot exceed 20% of the house price or $40k
- All quotes must be provided upfront with the offer on the home
- You have 120 days to complete all of the work after the closing with your own funds
- After the work is completed, a paid invoice will need to be provided or an inspection report proving the work has been completed
- After this is approved, the funds will be released to reimburse you for the improvement costs

Let's break these down in further detail:

<u>Renovations cannot exceed 20% of the purchase price or $40k</u>

If the renovations exceed this amount, you will need to pay for the remainder yourself as it cannot be built into the mortgage. The renovations must be for items that are fixed to the home. For example, if you are looking to purchase appliances, then this wouldn't be covered. However, if you were looking to replace the cabinets and countertops, these upgrades would be covered. The idea is that you will be increasing the value of the home through the cost of the improvements. Sometimes the lender will decline some of the renovations if they don't feel that they will bring additional value to the home. Every situation is dealt with on a case-by-case basis, and it also depends on the initial value of the home. For example, if you were looking to spend $20,000 on paint and a chandelier, then you can likely expect this to be declined. However, if you looking to lay all new flooring or add/remodel a bathroom, this is viewed much more favourably by lenders.

<u>All quotes must be provided upfront with the offer on the home</u>

Once you have an accepted offer on the home, you will need to get the quotes right away. This tends to be one of the more challenging aspects to co-ordinate, but a mortgage commitment will not be granted until these are provided. The lender needs to know the exact dollar figure to build into the mortgage and they also need to verify that the scope of the work is expected to increase the value of the home. If you are looking to apply for this program, you will need to get the quotes ASAP.

<u>You have 120 days to complete all of the work after the closing</u>

Once the closing date on the home arrives, you then have 120 days to complete all of the renovations. I highly recommend that you do not exceed this time frame as the lender can cancel the reimbursement for renovations. In that scenario, they would deduct it from the mortgage. If you have concerns that you might not complete it on time, then be sure to inform your broker right away—do not leave it to the last minute!

<u>You are required to pay for the renovations from your own funds</u>

This is one of the most common misconceptions of the program. Clients often think that they will receive the funds to complete all of the work as they wish on closing. Do you see the issue here? The lender has no way to ensure that the work gets done. That Purchase + Improvements money could easily turn into Purchase + Vacation money for some.

<u>After the work is completed, a paid invoice or an inspection report proving the work has been completed will need to be provided</u>

There are two ways the lender can verify that the work is complete: a paid invoice or an inspection report. Sometimes the lender mandates an inspection report or gives the option between the two. Typically, if you are doing the work yourself and the quotes are for materials, then they will require an inspection report at your cost. You must ensure that the work listed in the quotes is completed on the home. If you don't complete 100% of the work as stated, you may jeopardize the release of the funds. Also, if you get a quote from one contractor and then decide to use someone else, you will most likely need to obtain an inspection report over the new paid invoice.

Mortgage Refinance

A refinance occurs when someone owns a home and they are looking to consolidate debt or obtain equity. A refinance is essentially a new mortgage with a higher amount replacing an existing one. It can be a beneficial process in numerous ways, such as obtaining funds to complete renovations on your home or paying off high-interest consumer debt, such as credit cards.

There are a couple key points that must be considered when doing a refinance. The highest mortgage amount you can refinance up to is 80% of the home's appraised value. If your mortgage balance currently exceeds 80% of the value, then a refinance is not possible. For example, if your home is worth $300k, the most you can refinance up to is $240k. For example, if your existing mortgage is $260k than a refinance will not be possible. In a steady housing market, it will likely take five years to build up a 20% equity stake in the home with appreciation and mortgage pay down. Another thing to consider is where you are at in the term of your mortgage. If you are up for renewal, then there won't be any penalties. However, if you are breaking your mortgage mid-term, you will want to find out how much the penalty is first.

Spousal Buyout

A spousal buyout is a unique program where you can essentially take over the home from your ex by leaving as little as a 5% equity stake in the home. In a way, it essentially operates like a refinance transaction. However, this program lets you go up to 95% loan to value instead of 80%. A separation agreement needs to be prepared, and the ex will need to be removed from title on closing.

Example

Thomas and Brittany have a home that is worth $100k with an existing mortgage of $80k. Thomas has decided to buy out Brittany as per their separation agreement. She wants $10k for the equity in the home and $5k to pay out a joint credit line they held. Thomas applies for a spousal buyout mortgage of $95k and gets approved. Upon closing, Brittany will be taken off title and given $10k for her portion of the equity and the remaining $5k will go to pay out and close their joint credit line. Thomas will then own the home solely in his name with a new mortgage of $95k.

HELOC (Home Equity Line of Credit)

A HELOC mortgage can be a viable option when you want to quickly access the equity in your home. The minimum down payment requirement is 20% on a purchase and you can never tap into more than 80% of the home's value. This product is only recommended for someone who is very diligent about their finances. Making it this easy to access the equity in your home can be a very big problem if you're constantly drawing funds and never paying your mortgage down. However, in the right circumstances, this can be very valuable—especially for self-employed individuals with a fluctuating income. It also works well for people who want to grow their rental portfolio by drawing on their equity to purchase another rental property. So why doesn't everyone do this instead of a refinance? The main reason is that the interest on the portion you can draw down is at a higher rate than the fixed portion of the mortgage. In simple terms, the overall rate for a refinance is more favourable.

Reverse Mortgage

Although this is not something that will apply to a first-time home buyer—or a millennial, for that matter—it is worth mentioning how they work. A reverse mortgage is available to homeowners aged 55 years or older. It allows you to access a portion of the equity in your home in either a lump-sum payment or in continuous monthly income payments. There are no monthly mortgage payments; instead, the interest payments compound on the remaining equity in your home. Once you pass away, the bank is entitled to that accumulated interest and any remaining equity goes to your estate.

Low-Rate Basic

Each lender has their own name for this product, but essentially, it offers a rock-bottom low rate with limited flexibility. Typically, this rate will be 0.10% lower than the lowest rates available. Here's the catch: if you break the mortgage during the term (even if you sell the home), you will trigger a penalty that is usually 3% of the balance of the mortgage, even on a variable-rate mortgage. This is one thing you should always double check and look out for. That said, your broker should advise you beforehand if you want to go down this route. You can find out if you are being offered this product by looking in the pre-payment privileges section. It should clearly outline that if you break this mortgage at any time, X% will be charged on the outstanding balance.

Cash-Back Mortgages

Who doesn't love cash back? Especially after using a large portion of your savings for a down payment. However, don't confuse a cash-back mortgage with free cash! At times some lenders do offer a fixed cash amount on closing as a promotional offer which is different than a cash-Back mortgage. Cash-back mortgages typically range from 1% to 5% of the mortgage amount paid in cash on closing. It sounds too good to be true, right? Well, the catch is that the lender will charge a higher interest rate to offset the cash they are giving out. Remember, nothing is free in life. You can almost always be assured that you will pay more with the cash-back mortgage than a traditional mortgage, and this additional cost can be very significant. From an expert's point of view, if possible, I would avoid this type of mortgage at all costs. However, in some very specific situations, it may make sense. If this is something you are considering, have your broker run comparative amortization schedules for both options so you can see the amount of interest and the difference in principal that you are paying with both options. On a side note, if you break your mortgage before the end of your term, you will be required to pay back every dollar you received as a cash-back payment.

Conclusion

This brings us to the end of the book. You should have a strong understanding of what you need to do to successfully secure your first mortgage. The most important thing to remember is that there are three essential requirements that need to be satisfied to obtain a mortgage: credit, income and down payment. As long as you can satisfy all three of these categories, you can get approved for a mortgage. If you can't satisfy one of these categories, then you may need to wait until the issue is resolved or explore alternative options.

So, how do you feel about mortgages now? Do you consider yourself a pro or are you overwhelmed by the complexity? Hopefully, this book has given you some valuable insights into the process and answered any of the questions you may have had about mortgages. The good news either way is that you don't have to take on the work and stress of securing your own mortgage—a good mortgage broker will handle everything for you.

Finding a good mortgage broker is just as important as finding a good realtor. Do your research. Read reviews online and ask your friends and family for recommendations. No matter where you are located, if you ever want to work together, I would be more than happy to help you. Even if you just have a question about mortgages or want some further insights into any of the concepts explained in this book, please don't hesitate to reach out.

I wish you all the best on your journey!

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