Basics of a mortgage

Jacques Robert
REAL ESTATE LAW

Obtaining the best mortgage for your new home purchase requires taking an honest assessment of your financial situation and working closely with your financial institution. To this end, it is important to understand some basic mortgage terminology in under to better understand your mortgage product. In a new home purchase, the role of the solicitor is to take instructions from the clients' financial institution in order to register the mortgage on title to the property. Any discussion and negotiation of the mortgage details occurs strictly between the borrower and the financial institution.

The term of a mortgage refers to the length of time that your mortgage options and interest rate are in effect. At the end of the term, it will be necessary to renegotiate your mortgage, which means the possibility of a new rate and repayment options. The term is sometimes confused with the amortization period. The amortization period is how long it will take to pay off the mortgage based on the monthly payments and interest rates. Longer amortization periods reduce monthly payments, as the mortgage takes longer to pay off. If your down payment is less than 20% of the purchase price, 25 years will be the longest amortization period available.

The interest rate you pay on your mortgage may be fixed or variable. A fixed rate stays the same for the term of the mortgage while a variable rate changes according to market factors. Fixed interest rates are generally higher than variable rates, however a fixed rate keeps payments the same for the term and allows you to know how much of the principal will be paid off by the end of the term. Even small changes in interest rates can have significant impacts on mortgage payments. With a variable rate mortgage, some lenders offer an interest rate cap or convertibility, which allows you to change from a variable to a fixed interest rate.

Mortgage payments are divided between the interest and the principal. The principal is the initial amount that was borrowed. Payments are first applied to the interest, and then toward the principal. As a result, with a new mortgage, most of the payment amounts will be applied to the interest. Initially, the principal will only slightly decrease. As the mortgage balance decreases, the amount paid to interest will decrease and more of the payment will go to the principal. The frequency with which the payments towards the mortgage are due is called the payment schedule. This can be weekly (52 payments per year), biweekly (26 payments per year), semi-monthly (24 payments per year), or monthly (12 payments per year). With weekly and biweekly payment frequencies, there is often the option to make accelerated payments which allow for one extra month of payment per year.

Mortgages can be open or closed. An open mortgage allows you to pay your mortgage in full or make additional payments at any time without any penalties, as well as renegotiate your mortgage before the end of the term. A closed mortgage is more limited in the availability of these benefits however closed mortgages may have more favorable interest rates than open mortgages.

A factor that will greatly influence your mortgage is the amount of the down payment made when purchasing the house. The minimum down payment amount is 5% on homes with a purchase price of $500,000 or less. This rises to 20% on home with a purchase price of $1,000,000 or more. A higher down payment results in less money being borrowed for the mortgage loan amount and therefore less paid in total interest over the course of the mortgage loan

A mortgage for over 80% of the value of the home is known as a high-ratio mortgage. When making a down payment of less than 20%, mortgage insurance is required. Mortgage insurance offers protection to the lender in the event payments are not made, however it is the borrower that pays the insurance premium. Depending on the amount of your mortgage and the amount of your down payment, the mortgage insurance premium will vary. This premium can be added to your monthly mortgage payments, or paid up front in a lump sum. If the mortgage insurance premium is added to the mortgage loan, more interest will need to be paid because the amount of the loan will have increased. Over a 25 year mortgage this can represent a significant increase in the amount to be repaid and will result in an increase in the actual amount paid for the mortgage insurance premium.

These are just some of the basic points to be aware of when considering a mortgage. More details will be available through your financial institution.

co-authored with Mark Armitage, associate lawyer

Jacques Robert is an Ottawa real estate lawyer. For more information, visit www.jacquesrobert.com