



Financial Consumer  
Agency of Canada

Agence de la consommation  
en matière financière du Canada

# The ABCs of Mortgages



Protecting Consumers



Informing Canadians

Disponible en français

Canada 

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## Before You Apply for a Mortgage

### Amortization

The amortization is the length of time it takes to pay off a mortgage, assuming that the interest rate and payment amount do not change, that all payments are made on time and that no additional payments are made.

In Canada, typically, the longest amortization period is 25 years, although some institutions may allow a longer period. It is to your advantage, however, to choose the shortest amortization period that you can afford. This will save you thousands of dollars in interest in the long run. The following table shows how much interest is paid (over the entire amortization period) on a \$150,000 mortgage, assuming a constant annual interest rate of 6.45 per cent.



<b>Example – Amortization vs. interest paid</b>			
<b>Mortgage amount</b>	<b>Amortization</b>	<b>Monthly payment</b>	<b>Interest paid</b>
\$150,000	25 years	\$1,000	\$150,060
\$150,000	20 years	\$1,105	\$115,550
\$150,000	15 years	\$1,295	\$83,200
\$150,000	10 years	\$1,690	\$53,150

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## *Term*

The amortization of a mortgage is divided up into smaller time periods called “terms”. Mortgage terms usually range from six months to five years, but some institutions will offer seven- or 10-year terms. The term is the period of time during which, with fixed-rate mortgages, the interest rate and payment amount are fixed. With variable-rate mortgages, the payment amount may, or may not, change; you should review your agreement to check when the payment amount may change. At the end of the term, you can renew your mortgage for a new term, at prevailing interest rates.

Generally, the longer the term, the higher the interest rate. Because it is not possible to know what the interest rates will be over any given period of time, many consumers seeking certainty choose a longer term with a fixed interest rate so that they know in advance, at least for a specified period, how much they will have to pay for their mortgage. This helps them to plan their finances better and enhances their feeling of security. However, during periods when interest rates are expected to fall, many consumers choose variable-rate mortgages so they can take advantage of lower rates without renegotiating their mortgage.

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## *Payment Options*

Most financial institutions offer a number of payment options (monthly, semi-monthly, bi-weekly, accelerated bi-weekly, weekly, and accelerated weekly payments). Although these options may all seem the same, some payment methods such as accelerated weekly and bi-weekly payments can save you a lot in interest charges, compared with regular monthly payments.

The table on the following page illustrates the savings in interest you can get with various payment options. It assumes that you have a mortgage of \$150,000, amortized over 25 years, with a constant interest rate of 6.45 per cent. As you will note, choosing the accelerated weekly or bi-weekly payment option can save you thousands of dollars in interest charges over the duration of your mortgage.

### Example – Interest savings resulting from various payment options\*

	Payment	Frequency	Amortization	Interest paid	Interest saved
Monthly	\$1,000	Every month	25 years	\$150,060	—
Semi-Monthly	\$500	24 times a year	25 years	\$149,660	\$400
Bi-Weekly	\$460	26 times a year	25 years	\$149,630	\$430
Weekly	\$230	52 times a year	25 years	\$149,455	\$605
Accelerated Bi-Weekly	\$500	26 times a year	20.7 years	\$120,650	\$29,410
Accelerated Weekly	\$250	52 times a year	20.6 years	\$120,300	\$29,760

\* Note: For illustration purposes, numbers in this example have been rounded off. Each institution may calculate interest differently. The interest paid and saved was calculated over the period of amortization of the mortgage.

#### Monthly

With monthly payments, funds are taken from your account on a specific day once a month (or 12 times a year); for example, on the first day of each month. This type of payment does not result in any interest savings when compared to the other payment options that follow.

#### Semi-monthly

If you choose the semi-monthly payment option, half of your monthly payment amount will be taken from your account twice a month (e.g., on the 1st and 15th of each month), and you will make 24 semi-monthly payments a year. This type of payment does not result in any significant interest savings.

#### Bi-weekly (non-accelerated)

With the non-accelerated bi-weekly payment, you make a payment every second week (e.g., every second Thursday). Since there are 52 weeks in a year, you will make 26 payments a year ( $52 \text{ weeks} \div 2$ ). To calculate the amount of your bi-weekly payments, multiply your monthly payment by 12 and divide it by 26 ( $\$1,000 \times 12 \div 26 = \$461.54$ ). This type of payment does not result in any significant savings in interest.

#### Weekly (non-accelerated)

With the non-accelerated weekly payment, you make a payment every week (e.g., every Thursday). Since there are 52 weeks in a year, you will make 52 payments in a year. To calculate the amount of your weekly payments, multiply your monthly payment by 12 and divide it by 52 ( $\$1,000 \times 12 \div 52 = \$230.77$ ). This type of payment does not result in any significant interest savings.

### **Accelerated bi-weekly**

The accelerated bi-weekly payment allows you to pay half of your monthly payment every two weeks (e.g., every second Thursday). Since there are 52 weeks in a year, you will make 26 payments a year (52 weeks ÷ 2). By doing this, you make the equivalent of one extra monthly payment a year, which means you pay off your mortgage faster and save interest charges.

### **Accelerated weekly**

If you choose the accelerated weekly payment, one-quarter of your monthly payment amount will be debited from your account every week (e.g., every Thursday). Since there are 52 weeks in a year, you will make 52 payments a year. As with the accelerated bi-weekly option, you make the equivalent of one extra monthly payment a year, which means you pay off your mortgage faster and save on interest charges.

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## *Types of Mortgages*

### **Fixed-Rate (Closed) Mortgage**

With a fixed-rate mortgage you benefit from the security of locking in your mortgage interest rate for a predetermined length of time, usually ranging from six months to five years. Other terms such as three months, or six, seven and 10 years are also available.

If you think interest rates will increase, you may want to choose a longer term, such as a five-year term. If you think that rates are going to decrease or remain relatively stable

for a long period of time, you may want to choose a shorter term.

Most lenders will allow you to make additional payments on your mortgage without any penalty. These could amount to as much as 25 per cent of your original mortgage amount (depending on the institution). However, if you want to pay more than the annual allowable maximum, or pay off the entire mortgage at any time, you will generally have to pay a penalty. Make sure you understand this before choosing your term.

### **Open Mortgage**

An open mortgage allows you to pay off part of your mortgage, or the entire mortgage, at any time without any penalty. Open mortgages usually have a short term, ranging from six months to one year. The interest rate is usually higher than the fixed rate for a closed mortgage with a similar term. One situation where an open mortgage may be appropriate is if your house is for sale and you want to repay the financial institution with the money you get from the sale.

### **Variable Interest-Rate Mortgage**

At the start of a variable interest-rate mortgage, the lender will calculate a mortgage payment that includes both the principal and interest. During the term of the mortgage, your payments usually do not change. However, as the base rate for the variable interest-rate mortgage changes, so will the interest rate on your mortgage.

If interest rates drop, less of each payment will go towards paying interest and more will go towards paying off the principal. If interest rates rise, more of your payment will go towards paying interest and less will go to reducing the principal.

Some variable-rate mortgages are completely open (you can pay off all or part of your mortgage at any time, without a penalty). Others may be closed and charge a penalty for paying off all or part of the mortgage.

### **Convertibility Feature**

A mortgage with a convertible feature allows you to renegotiate your interest rate (renew it early) before the maturity date. However, not all lending institutions offer a convertibility feature. With a convertible rate mortgage, you can lock into a longer term during the current term of your mortgage without paying a penalty – but only if you stay with the same lender. For example, if after a couple of months you see that interest rates are going to increase, you may change to a longer-term mortgage such as a five-year term. The convertibility feature is often on variable interest-rate mortgages or fixed-rate mortgages with short terms.



### **Adjustable-Rate Mortgage**

An adjustable-rate mortgage is a mortgage where the interest rate and payment amount are adjustable from time to time during the term.

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### *Down Payment*

The down payment is the amount of money that you pay upfront towards the purchase of your home. You should have a good idea of how much you can put towards the down payment before talking to a potential lender or broker.

The minimum down payment for the purchase of a home depends on many factors (geographic location, the type of house, its cost, etc).

Normally, the minimum down payment required for the purchase of a single home or condominium is five per cent of the accepted purchase price (or appraised value, whichever is lower). Usually, for the purchase of a 2-unit home (duplex), the minimum down payment is 7.5 per cent, and for a 3-unit home (triplex) or 4-unit home, 10 per cent. However, the less you need to borrow, the less interest you will have to pay.

If your down payment is less than 25 per cent, your mortgage is considered a “high-ratio” mortgage. In this case, the mortgage lender must, by law, require you to purchase mortgage loan insurance (or “default insurance”). If your down payment is 25 per cent or more, your mortgage is considered a “conventional” mortgage and does not, by law, have to be insured. However, a lending institution may still require mortgage default insurance for a high-risk loan, despite the fact that the law does not require it.

Normally, the down payment you make must come from your own funds. If you borrow the money (such as on a line of credit, personal loan or credit card), a higher mortgage loan insurance premium applies. See the “Mortgage Loan Insurance” section, page 8, for more details.

### **Home Buyers’ Plan (HBP)**

If you are a “first-time homebuyer”, the Home Buyer’s Plan (HBP) could help you find the money you need for your down payment, or allow you to make a larger down payment on your home.

The HBP is a program administered by the Canada Revenue Agency (CRA) that allows you to withdraw up to \$20,000 from your registered retirement savings plan (RRSP) to buy or build a home. Withdrawals that meet all applicable HBP conditions do not have to be included in your income, and your RRSP issuer will not withhold tax on these amounts. If you buy the home together with your spouse or partner, or other individuals, each of you can withdraw up to \$20,000.

Under the HBP, you have to repay all withdrawals to your RRSP within a period of no more than 15 years. Generally, you will have to repay an amount to your RRSP each year, starting the second year following your withdrawal, until you have repaid the whole amount you withdrew. If you do not repay the amount due for a year, it will be included in your income for that year.

#### *Example: HBP Reimbursement*

In 2002, Martin withdraws \$6,000 from his RRSP to participate in the HBP. Martin’s minimum yearly repayment, starting in 2004, will be \$400 ( $\$6,000 \div 15$ ).

If Martin decides not to make any reimbursement in 2004, he will have to include \$400 in his 2004 income. His minimum yearly HBP repayment, however, will remain at \$400 for the following years.

On the other hand, if Martin decides to make a HBP reimbursement of \$1,000 in 2004, his minimum yearly repayment for 2005 and the following years will be \$357.14 ( $[\$6,000 - \$1,000] \div 14$ ).



To be eligible for the HBP:

- You must have a written agreement to buy or build a home. (A pre-approved mortgage alone will not be accepted.)
- You have to intend to occupy the home as your principal residence.
- You have to be considered a first-time homebuyer. You are not considered to be one if you or your spouse owned and occupied a principal residence at any time four years before the year (starting January 1) of withdrawal.
- Your HBP balance on January 1 of the year you withdraw has to be zero.

*Example:*

In 1995, Jane withdrew \$7,500 from her RRSP to participate in the HBP. She chose to make only the minimum reimbursement of \$500 ( $\$7,500 \div 15$ ) per year. Jane made her first \$500 HBP repayment in 1997. Her final repayment will be made 15 years later, in 2011. In January 2012, Jane's HBP balance will therefore be zero. This means that Jane cannot withdraw more funds from her RRSP, as part of a HBP plan, before January 2012.

- You have to make all withdrawals in the same year. **Note:** If you take an amount from your RRSP in one year and another in January of the following year, the amount received in January of the following year will be treated as if it had been received in the year the first withdrawal was made.

*Example:*

On October 15, 2001, Mary withdrew \$7,500 from her RRSP under the HBP. Before the withdrawal, Mary had entered into a written agreement to buy a home. In March 2002, she withdrew an additional \$1,500 to pay expenses she had not anticipated. Because Mary's second withdrawal was made after January 2002, it is not considered an eligible withdrawal and must be included in her income for the year 2002.



- Neither you nor your spouse can have owned the home 30 days before the date of withdrawal.
- You have to buy or build the home before October 1 of the year after the year of withdrawal. The home is considered “built” on the date it becomes habitable. **Note:** some extensions can be provided — contact CRA for details.

### *Example:*

On February 20, 2002, Steven withdraws \$15,000 from his RRSP under the HBP. Earlier in the same month, he finalized a contract to have his home built. For his withdrawal to be eligible for the HBP, Steven’s home will have to be habitable by October 1, 2003. Otherwise, Stephen will have to either get an extension agreement from CRA or include his withdrawal in his income for 2002.

- Your RRSP contribution must be in your RRSP for at least 90 days before you make a withdrawal.
- You have to be a Canadian resident.

Before you make a decision on whether you will use the Home Buyer’s Plan, it is important to look carefully at the pros and cons of using your RRSP to buy a home. There are a number of questions you should be thinking about before making such a decision. For example, will you be able to make the annual repayment to your RRSP each year? Is it to your advantage, or is it the right timing to cash in your RRSP

(i.e., what is the interest rate you are earning on your RRSP compared with the interest rate on your mortgage)? Is it worth giving up the interest and growth potential of your RRSP in favour of reducing the interest you will have to pay on your mortgage?

Your financial advisor can help you find answers to these and other questions that you may have. You can also find out more about the Home Buyer’s Plan by contacting the Canada Revenue Agency (1-800-959-8281, [www.cra-arc.gc.ca](http://www.cra-arc.gc.ca)).

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### *Mortgage Loan Insurance*

High-ratio mortgages (mortgages with less than 25 per cent down payment) must, by law, be insured against default. This type of insurance is offered by the federal government through the Canada Mortgage and Housing Corporation (CMHC) or through an approved private insurer (such as GE Capital Mortgage Insurance Canada). With mortgage loan insurance, if you default on your mortgage, the lender is paid back by the insurer.

It should be noted that mortgage loan insurance protects the lending institution only. If you default on your mortgage and the proceeds from the sale of your house are not sufficient to pay the outstanding balance on your mortgage, the lending institution will be covered by mortgage loan insurance. Note that, in such a case, you would still lose your house.

Before approving you for mortgage insurance, the mortgage insurer generally makes an assessment of your credit and

may require you to pay an application or appraisal fee to process your file and confirm the approval of the mortgage. This fee covers the insurer's costs associated for that assessment. In some cases, the lending institution may pay this fee.

Normally, the down payment you make must come from your own funds. If you borrow the money (such as on a line of credit, personal loan or credit card), a higher mortgage loan insurance premium applies (see the following table).

The mortgage loan insurance premium may be paid in cash or added to your mortgage. Although the second option seems interesting, remember that it is more costly, since you would have to pay interest charges on the amount of the premium.

Home ownership insurance premiums are shown in the table below:

Conventional mortgages (mortgages with at least a 25 per cent down payment) do not, by law, have to be insured. However, there may be instances where mortgage insurance will be required if your loan is considered risky. In this case, some lenders may charge a premium of 0.65 per cent if your down payment is between 25 and 34.99 per cent or 0.5 per cent if your down payment is above 35 per cent (rates effective July 2003).

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### *Credit Rating*

When you apply for a mortgage, the lender checks to see whether it should lend you the money, and under what conditions.

The lender will ask your permission to obtain a copy of your credit bureau report. This report shows your previous and current credit rating and indicates how well (or not) you handle credit. If you do not handle credit well, you may be charged a higher rate, or your application may be denied depending on the financial institution.

<b>Down Payment</b>	<b>Insurance Premium<sup>1</sup></b>
0% to 5% down payment, from borrowed funds	2.90%
5% to 9.99% down payment	2.75%
10% to 14.99% down payment	2%
15% to 19.99% down payment	1.75%
20% to 24.99% down payment	1%

<sup>1</sup> On accepted purchase price or appraised value (whichever is lower) — Effective April 22, 2005.

If you consistently make late payments, or if you do not pay your bills at all, the lender could refuse your mortgage application. Some lenders may still consider your application if you have a large down payment and an acceptable co-signer.

If you have previously declared bankruptcy, this will show up on your credit bureau record for a minimum of six years after your discharge. While some lenders will not consider your request if a Discharge of Bankruptcy is recorded on your credit bureau report, others may consider the request based on your current circumstances and amount of down payment.



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### *How Can You Get More Information About Your Credit Report?*

You should request a copy of your credit file at least once a year. This is also important before you apply for a mortgage, to make sure that there are no mistakes on your credit report. This service is usually provided free of charge. To request your credit report, contact the following credit-reporting agencies:

#### **Equifax Canada**

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

#### **TransUnion Canada**

All provinces except Quebec:  
TransUnion  
Consumer Relations Centre  
P.O. Box 338 LCD 1  
Hamilton, Ontario L8L 7W2  
Tel. (toll-free): 1-866-525-0262  
Fax: (905) 527-0401  
Web site: [www.transunion.ca](http://www.transunion.ca)

For Quebec residents:

TransUnion (Echo Group)  
1 Place Laval, Suite 370  
Laval, Quebec H7N 1A1  
Tel. (toll-free): 1-877-713-3393  
Fax: (905) 527-0401  
Web site: [www.transunion.ca](http://www.transunion.ca)

#### **Northern Credit Bureaus Inc.**

336 Rideau boulevard  
Rouyn-Noranda, Quebec J9X 1P2  
Fax (toll-free): 1-800-646-5876  
Web site: [www.creditbureau.ca](http://www.creditbureau.ca)

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### *How Can You Get an Error Corrected on Your Credit File?*

If you find an error or inaccuracies on your credit report, you may contact the credit bureau directly to have the errors corrected. However, the bureau must then contact the organization that reported the erroneous information, since it cannot make a correction without first confirming that an error has been made.

Credit bureaus are bound by provincial legislation. In most provinces, credit bureaus must resolve disputes within 30 days (although Alberta allows 90 days). This means that the credit bureau must contact the organization that gave them the information and, if they determine that an error has been made, they have 30 days to correct your credit file. If the bureau confirms that the information has been reported accurately but you are still not satisfied with the result, you can submit a brief statement explaining your position, which will be added to your credit file.

To avoid delays in having errors on your credit file corrected, you can contact the organization that provided the incorrect information (for example, your financial institution or your credit card issuer) and ask that they correct the error. If your financial institution will not correct the error, you may ask them about their complaint-handling process. Financial institutions that operate under federal laws, such as banks, some trust and loan companies and some insurance companies, are required by law to have such a process in place. This process is designed to resolve disputes between consumers and their financial institutions. For information

regarding your financial institution's complaint-handling process, contact the Financial Consumer Agency of Canada (FCAC) toll-free at: 1-866-461-3222, or contact your branch directly.

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### *Special Options and Coercive Tied Selling (forced purchases)*

When you buy a house, you may be shopping around for more than one financial product. In addition to a mortgage, you may be looking for house insurance, life or disability insurance, a line of credit, etc.

Most financial institutions can offer products and services to complement your mortgage. Some lenders may even offer you better conditions on your mortgage if you take mortgage life insurance through them, or if you transfer your investment portfolio to them. Although such offers may seem interesting, it is a good idea to get quotes from other providers of these services and products, to ensure you get the best deal.

Remember that if you renew your mortgage or transfer your mortgage to another financial institution, the special options (e.g., your life/disability insurance) will not automatically be renewed or transferred with the mortgage. You might have to re-apply for these options.

Also, don't forget that, in accordance with federal law, a federally regulated financial institution cannot apply undue pressure on you to buy another of its products as a condition for accepting your mortgage application. If you have experienced this type of "coercive tied selling" at a bank, do not hesitate to contact FCAC.

## *Your Responsibilities*

### *Know Yourself – How Much Can You Afford?*

Before you start shopping for a house, and for a mortgage, it is important for you to determine how much you can afford.

#### **Pre-approval**

The easiest way to find out is to ask for a “pre-approval” from a financial institution. To do this, you submit your financial information to a potential lender, which approves you for a predetermined mortgage amount. The pre-approval agreement, which normally does not involve any obligation on your part (you are not signing a mortgage contract), may also guarantee the interest rate for a mortgage taken out during the 60- to 120-day pre-approval period.

#### **Look at your financial situation**

Although you may find the financial institution’s pre-approval convenient, remember that the pre-approved loan represents the maximum amount you could pay for a house, according to the lender’s criteria and the information you have provided. However, it may overestimate what you can actually afford, since it does not take into account the extra costs associated with purchasing a house (for example, the unexpected expenses you may incur from time to time, changes in interest rates that might substantially increase your housing costs, and any other



future financial obligations such as the replacement of a car). It is therefore important that you fully understand what your financial situation is and your financial plan to handle future payments.

Before you start shopping for a house, keep track of your monthly income and expenses to determine how long you need to save to accumulate the required down payment to purchase the house that you have chosen, and whether you can afford the monthly mortgage payments.

As a rule of thumb, your maximum monthly housing costs should not exceed 32 per cent of your gross monthly income, and your monthly debt payments should not exceed 40 per cent of your gross monthly income.

In fact, your ratios should be lower than the maximum outlined above, to give you flexibility in case of unexpected expenses, or changes in your mortgage conditions (e.g., a sharp increase in the interest rate when you renew your mortgage).

### **Extra costs**

Remember that there is more to buying a home than paying the down payment and mortgage. You'll need to budget another 1.5 to 4 per cent of the price of your home to cover extra costs such as legal fees, land transfer tax and tax adjustments.

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### **Shop Around**

Your mortgage is likely the most important debt that you will take on in your lifetime. It is therefore important that you look for a mortgage with the most beneficial conditions, which will save you money.

### **Lenders**

Mortgages are available from several types of lenders such as banks, mortgage companies, insurance companies, trust and loan companies, credit unions and caisses populaires. Different lenders may have different prices and conditions for similar products, so you should talk to several lenders to make sure you're getting the best product for your needs.



### **Mortgage brokers**

You can also obtain a mortgage through a mortgage broker. Rather than lending money directly to you, brokers arrange transactions by finding a lender for you. Since brokers have access to a number of lenders, this may give you a wider range of loan products and terms to choose from. However, since mortgage brokers do not all have access to the same financial institutions, they may not be able to offer you the same kind of product. Consequently, you should consider contacting more than one broker, just as you should with banks and other financial institutions.

Some lending institutions may pay brokers' fees. If a broker cannot find you a product that is better than the one at your institution, you are free to shop elsewhere.

To obtain a list of mortgage brokers in your area, visit the Web site of the Canadian Institute of Mortgage Brokers and Lenders at [www.cimbl.ca](http://www.cimbl.ca), or call them (toll-free) at 1-888-442-4625.

If you obtain your mortgage through a broker, remember that the consumer protection measures outlined in this document will only apply if the lender is regulated by the federal government. For a complete list of federally regulated financial institutions, visit the Web site of the Office of the Superintendent of Financial Institutions at [www.osfi-bsif.gc.ca/eng/whoweregulate.asp](http://www.osfi-bsif.gc.ca/eng/whoweregulate.asp).

For information about the consumer protection measures that apply to provincially regulated financial institutions, please contact your provincial government.

### **Ask the right questions**

When you shop around at various financial institutions and mortgage brokers, you should obtain the information you need to compare products and avoid any surprises, before committing yourself to a contract.

The following section, “Your Rights”, outlines the information you have the right to receive when you apply for a mortgage at a bank or another financial institution regulated by the federal government. This information will enable you to compare the various lenders and help you make a decision. You can use the information presented in the next section as a checklist that you can take with you when you speak to lenders or brokers. Be sure to write down the information they give you. Don’t be afraid to let lenders know that you are shopping around for the mortgage that best suits your needs.




## Your Rights

### *When You Apply for a Mortgage — Information That Must Be Provided to You<sup>1</sup>*

Banks, insurance companies and trust and loan companies that are federally regulated **must** provide you with the following information, before you sign a mortgage agreement or contract.

If you applied for a fixed-rate mortgage:

- the amount that is being lent to you;
  - the term of the loan and the period of amortization;
  - the total of your payments at the end of the term;
  - of that total, how much you will have paid in interest charges at the end of the term;
  - your annual interest rate;
  - the real annual interest rate, when you include the extra charges related to your mortgage (e.g., administrative fees, brokers' fees, etc.) that the lender might add on top of your interest charges. **Note:** This rate is also called the "APR" (annual percentage rate);
  - the date on which you will start being charged interest;
- 
- the amount of your payments, and when they are due;
  - the fact that your payments will be applied first to cover interest and other charges, and then to the outstanding principal;

<sup>1</sup> This section covers the most common types of mortgages. However, if your mortgage arrangement is not discussed in this section (e.g., if your loan does not have regularly scheduled payments or if the variable interest rate is determined by a method other than those described here), please contact FCAC and we will let you know what information your institution must give you when you sign your contract or agreement.

- the optional services (e.g., disability or life insurance) you accepted, how much they cost, and what will happen, in terms of rebates, charges and penalties, if you decide to cancel these services;
- how the rebates, charges or penalties will be calculated if you decide to repay your mortgage before maturity;
- the default charges that may apply if your mortgage is in default for any reason;
- a description of the property (if any) being provided as a security for the loan;
- whether there were any broker fees – paid by the financial institution to a broker – included in the amount lent to you;
- whether you will have to pay a fee to discharge the mortgage when the financial institution’s interest in your home ends, after you pay it off, and how much this fee is quoted on the date of the disclosure statement;
- whether you will have to pay any other charges, in addition to interest and the other charges mentioned previously. If so, the type of charges and how much you will have to pay.

If you applied for a variable-rate mortgage:

If you applied for a variable-rate mortgage, your federally regulated bank, insurance company or trust and loan company must also provide you with the following information:

- the annual interest rate that applies to your mortgage as of the date of the disclosure statement;
- how the annual interest rate is calculated and when this calculation is made;
- how much your payments are, based on the annual interest rate, as of the date of the disclosure statement and when they are due;
- what your total payments will be at the end of your term, based on the annual interest rate as of the date of the disclosure statement;
- if you applied for a variable-rate mortgage and the amount of your mortgage payment is not adjusted automatically to reflect changes in the annual interest rate that applies to each payment (in other words, where your payment amount does not vary when the interest rate changes), you must be provided with the following information:
  - the annual interest rate above which your payments will not be sufficient to cover the interest due on your loan for the period; and
  - the fact that negative amortization is possible (this is when the outstanding balance you owe increases instead of decreases even if you make your payments in full).

- if interest rate variations are linked to a public index, the financial institution must provide you, at least once a year, with a disclosure statement containing the following information:
  - the annual interest rate and outstanding balance at the beginning and end of the period covered by the statement; and
  - the amount of each payment and when each payment is due, based on the annual interest rate that applied at the end of the period.

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### *When Your Mortgage Agreement Changes*

Your institution will generally not make changes to your mortgage agreement without your agreement. If your lending institution makes changes to your original mortgage agreement, it must provide you, in writing, with the details of these changes 30 days, at the latest, after the changes take effect.



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### *When You Renew Your Mortgage*

At the end of your mortgage term, if your lending institution wants to renew your mortgage, it must provide you with a new statement at least 21 days before the end of the existing term. This statement must contain the same information as when you apply for a new mortgage and may be combined with a mortgage renewal agreement. If the lending institution decides not to renew your mortgage, it must notify you about this decision at least 21 days before the end of your term.

Remember that you are not obliged to renew your mortgage with the same institution. Approximately four months before your renewal date, you should contact various mortgage brokers and lending institutions to find a new mortgage with the conditions that best suit your needs. If you do not shop around and negotiate, your mortgage will likely be renewed automatically, and you may not obtain the best interest rates and conditions.

## After You Have Applied for a Mortgage

### How to Pay Your Mortgage Off Faster

Any additional payment you make on your mortgage (also called pre-payment) will save you a lot of money in interest. Every normal payment you make consists of principal and interest. The interest portion of your payment is determined by the outstanding balance of your mortgage. As the outstanding balance diminishes, less of your payment goes towards interest and more comes off the balance.



#### Example – Principal vs. Interest

Mortgage balance	Rate	If the payment is	=	Amount applied to principal	+	Amount applied to interest
\$150,000	6.45%	\$1,000	=	\$205	+	\$795
\$100,000	6.45%	\$1,000	=	\$465	+	\$535
\$50,000	6.45%	\$1,000	=	\$730	+	\$270

The faster you reduce the outstanding balance on your mortgage, the more you will save in interest charges. Since pre-payment policies vary between institutions and types of mortgages, you should consult your mortgage agreement to fully understand the pre-payment options that may be available to you. Some ways to minimize your mortgage costs are:

- Accelerated bi-weekly payment option
- Keeping the same payments if you renew at lower rates
- Increasing the amount of your payments
- Making lump-sum payments
- Paying extra on your payment dates

#### *Accelerated bi-weekly payment option*

A good way to shorten your amortization may be to choose the accelerated bi-weekly payment option. This allows you to pay half of your monthly payment every two weeks. By doing this, you end up making the equivalent of one extra monthly payment a year. To see how this works, read the following example.

#### *Example: Accelerated bi-weekly payment option*

John pays \$1,000 per month for his mortgage. Since he makes this payment 12 times a year, his payments total \$12,000 at the end of the year.

Let's assume that John decides to make his payments every two weeks. His payments will be \$500 every two weeks ( $\$1,000 \div 2$ ) and he will make 26 payments ( $52 \text{ weeks} \div 2$ ) for a total of \$13,000 at the end of the year.

The following example illustrates how much you can save in interest charges if you choose the accelerated bi-weekly payment option, assuming your mortgage is \$150,000, at 6.45 per cent, amortized over 25 years.



### Example – Accelerated bi-weekly payment option

	Monthly	Accelerated bi-weekly
Payment	\$1,000	\$500
Amortization	25 years	22.58 years
Interest paid	\$150,059.80	\$120,648.46
Interest saved	–	\$29,411.34

Similar interest savings can also be obtained with the accelerated weekly payment option. If John decides to make his payments every week, his payment will be \$250 every week ( $\$1,000 \div 4$ ). He will make 52 payments (52 weeks) for a total of \$13,000 at the end of the year.

*Keeping the same payments if you renew at lower rates*

At the end of your term, when you renew or re-negotiate your mortgage, you may be able to obtain a lower interest rate, which will reduce your future payments.

An easy way to accelerate your mortgage payments is to maintain the same payments you were making during the previous term. The difference between your previous payments and your current (lower) payments will be applied to the principal, to reduce your mortgage balance and help you pay your mortgage down faster.

This is one of the easiest ways to pre-pay your mortgage, since it does not affect your budget and spending habits (you accelerate your mortgage payments, while continuing to make the payments you were accustomed to making during the previous term).

The following example shows how your new, lower interest rate allows you to make pre-payments of \$200 per month, while keeping the same payment you had during the previous term.



### Example – Keeping the same payments if you renew at lower rates

	Previous term	Current term
Interest rate	7.5%	5.5%
Monthly payment	\$1,100	\$1,100
Minimum payment required (given mortgage interest rate)	\$1,100	\$900
Difference – additional amount applied directly to the principal to further reduce your mortgage balance	\$0	\$200

#### *Increasing the amount of your payments*

Most lending institutions will allow you to increase the amount of your mortgage payments. Some institutions allow an increase once a year; others, only once per term.

The amount of increase allowed varies by lending institution and by type of mortgage, and can be as high as 25 per cent.

For example: If your current mortgage payment is \$1,000 per month, you may be able to increase it by \$200 to \$1,200 per month ( $\$1,000 \times 20\% = \$200$ ). The extra portion of the payment is applied as principal against the outstanding balance of your mortgage and accelerates your mortgage repayment.

The disadvantage is that this increase may be permanent (depending on the lending

institution), and it may be difficult to bring your payments back to their original amount. You should therefore make sure that you can handle new, higher payments until the end of your mortgage term.

#### *Making lump-sum payments*

Most lending institutions will allow you to make lump-sum payments against the principal. Since these amounts are applied to the principal only, they reduce the outstanding balance of your mortgage.

The amounts allowed vary by lending institution and by type of mortgage and can be up to 20 per cent, and sometimes more, of the original amount of your mortgage. If you borrowed \$100,000 originally and your institution allows you to make lump-sum payments of up to 15 per cent, you will be allowed to pay up to \$15,000 extra every year.

You can usually only do this once a year, and your institution generally determines when it can be done.

This pre-payment option is not cumulative. In other words, if you did not make additional payments on your mortgage this year, you will not be able to accumulate the percentage of pre-payment allowed and double your pre-payment next year. In the example provided, you would not be able to double your payment from \$15,000 to \$30,000, because you did not make a payment last year.

#### *Paying extra on your payment dates*

Most lenders will allow you to make additional payments on your mortgage, sometimes referred to as “double-up” payments. These extra amounts are applied to the principal only and reduce your mortgage balance, which helps you pay your mortgage off faster.

Although there are some limitations, which vary by institution and by type of mortgage, you can generally double your normal mortgage payment on any payment date. Some lenders may let you decide how much extra you want to pay (i.e., they may allow “partial doubling”) and when you can pay it. Your lender might even agree to automatically withdraw the money for the extra payment from your account each payment date.

With double-up payments, the limits on your payment increases are not as strict as with the pre-payment option outlined earlier (100 per cent rather than up to 25 per cent), and you may stop making double payments at any time.

Some institutions, however, may deduct your total extra payments from the amount of the lump-sum payment you are allowed to make (see “Making lump-sum payments”, page 21).

For example, let’s assume that your monthly payments on your original \$100,000 mortgage are \$1,000 and that you decide to make an extra \$500 payment each payment date, and that your institution allows “partial doubling” of the payment amount. Let’s also assume that your institution allows you to make lump-sum payments of 15 per cent of your original mortgage every year. Here is how some institutions will determine your maximum lump-sum amount for a given year.

#### *Example: Maximum lump-sum payment allowed*

Original mortgage amount	\$100,000
× 15 %	\$ 15,000
<b>Minus:</b>	
Extra payments (\$500 × 12)	– \$ 6,000
<b>Maximum lump-sum payment allowed</b>	<b>\$ 9,000</b>



When shopping around, it is important to ask the lender what the prepayment options and conditions are, so you can determine the best prepayment option for you.

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### *Penalty Charges*

If you are locked into a closed mortgage, you may want to break your current mortgage contract and negotiate a new mortgage at a lower rate. Some agreements do not allow for a mortgage to be renegotiated, but most do. Financial institutions will usually allow you to pre-pay your mortgage in full, but will add a penalty.

#### **How penalty charges are calculated**

Your penalty charges depend on what was stated in the original mortgage agreement or in the most recent renewal agreement that you signed.

If your agreement allows you to pay off or renegotiate your mortgage early, you will normally have to pay a penalty.

The penalty is generally the greater of:

- a) three month's interest on your current mortgage, calculated as follows:

$$A \times \frac{B}{12 \text{ months in a year}} \times 3 \text{ months}$$

**A** is the outstanding amount on your mortgage

**B** is the annual interest rate on your mortgage

- b) the interest rate differential which can be calculated as follows:

$$A \times \frac{B - C}{12 \text{ months in a year}} \times D$$

**A** is the outstanding amount on your mortgage

**B** is the annual interest rate on your mortgage

**C** is the current mortgage rate for a term similar to what is left on your existing mortgage

**D** is the number of months left to the end of your term

(**Note:** This example is a simplified method for calculating the interest rate differential. Some financial institutions calculate the penalty differently. You should check with your own financial institution for information on the method of calculation it uses.)



### *Example : Penalty calculation*

Jim started with a mortgage of \$100,000, at an annual interest rate of 8 per cent. He has 36 months left in his 60-month (five-year) term. His outstanding balance is \$97,218. Jim wants to break his mortgage and take out a new mortgage contract, to benefit from the lower interest rates currently being offered. He wants to know what penalty he would pay for doing so. Assuming that the current market mortgage rate for a 36-month (or three-year) period is 6 per cent, Jim would pay a penalty **based on the higher of the two amounts shown below** (because this is what his mortgage contract stipulates).

**Possible penalty options** (simplified for illustration purposes)

*a) Three months' interest penalty*

The penalty would be:

Outstanding balance  $\times$  Monthly interest rate of Jim's mortgage  $\times$  3 months

This would amount to:

$$\$97,218 \times (8\% \div 12 \text{ months}) \times 3 \text{ months} = \$1,944$$

*b) Interest rate differential penalty (based on the difference in interest rates)*

To obtain the interest rate differential, take the interest rate on Jim's mortgage (8%), minus the current market mortgage rate (6%):  $8\% - 6\% = 2\%$  (interest rate differential).

The interest rate differential penalty would be:

Outstanding balance  $\times$  Monthly interest rate differential  $\times$  Number of months remaining on Jim's mortgage

This would amount to:

$$\$97,218 \times (2\% \div 12 \text{ months}) \times 36 \text{ months} = \$5,833$$

**If Jim decided to break his mortgage, he would have to pay a penalty of \$5,833, since this is the higher of the two penalty calculations.**

This example uses a simplified method to calculate the interest rate differential for demonstration purposes. Ask your financial institution to provide the exact cost of paying off a mortgage before the maturity date.

If you initially received a discounted rate, the financial institution may apply this discount to your current mortgage rate. On the other hand, if you received a “cash back” instead of a discounted rate, the financial institution may ask you to reimburse a portion (or all) of the cash back you initially received.

Some financial institutions may also add an administration fee if you pay your mortgage off early or if you renegotiate your mortgage. This fee may be paid by the institution to which you are transferring your mortgage.

### **Tips to minimize penalty charges**

If you decide to break your mortgage to benefit from lower interest rates, you might be able to minimize the amount of penalty charges you have to pay. Keep in mind, however, that your lending institution may not offer this option. Look at your mortgage agreement to see what options are available to you or contact your branch.

#### *Making a lump-sum payment before renegotiating*

As mentioned in the section “How to pay your mortgage off faster”, page 18, many mortgage agreements offer a pre-payment option without penalty, which may allow you to pay up to 20 per cent, and sometimes even more, of your mortgage off in any given year. If it is possible to do so, you may want to pay a portion of your mortgage (if your financial institution allows this) before you renegotiate it. Your penalty would then be calculated on the outstanding balance after you have made your pre-payment.

In the example on the preceding page, if Jim had made a lump-sum payment of \$5,000 before breaking his mortgage, his penalty would have been calculated on an outstanding balance of \$92,218, instead of \$97,218, and his penalty would have been \$5,533, rather than \$5,833.

#### *Blend-and-extend option*

Some institutions also allow you to extend the length of your mortgage prior to your mortgage renewal date, to take advantage of the current low rates by creating a new blended rate and longer-term mortgage. This is called the “blend-and-extend” early renewal option. Not all financial institutions offer this option, and different institutions have different ways of calculating this option. The example on the following page gives you an idea of one common method of calculating the blend-and-extend option.



### *Example: Blend-and-extend option*

Linda has 12 months left in her 60-month (five-year) mortgage, at an interest rate of 8 per cent. Let's assume that the current five-year mortgage rate is 6 per cent. If Linda decided to extend her mortgage before its term ended and take on another five-year mortgage, her new mortgage rate, using the blend-and-extend option, would be as follows:

$$\frac{A + B}{C}$$

A is (8% x 12 remaining months in current term) = 0.96

B is (6% x 48 months of new term) = 2.88

C is 60 months (new term)

$$\frac{0.96 + 2.88}{60} = 6.4\%$$

If Linda chooses the blend-and-extend option, her mortgage rate will be 6.4 per cent for the next 60 months, and she will not have to pay a penalty to benefit from the lower rate. (**Note:** Your financial institution may add an administrative fee.)

It may be beneficial for Linda to choose the blend-and-extend option if she believes that interest rates will increase substantially before the end of the term of her mortgage and wants to lock in now.

The preceding method of calculating the blended rate has been simplified for illustration purposes. The formulas used by financial institutions are generally based on net present value; therefore, your actual blended rate will be different (it is usually higher). Contact your financial institution for the exact blended rate.

### Things to remember when you switch institutions

- A penalty may apply if you wish to switch institutions before the end of your mortgage term.
- You may have to pay legal fees to discharge the old mortgage and register the new mortgage.
- Other administration fees may also apply.
- Don't hesitate to ask the lending institution whether it is willing to pay part or all of these fees.
- If not, ask yourself if the savings of going to a new institution are greater than the cost of switching.
- Your new prepayment privileges will not be based on the original amount of your mortgage, but on the amount of the mortgage balance transferred to the other financial institution.



## Do's and Don'ts

There are a number of things you should take into consideration if you are looking for a mortgage, or if you already have a mortgage. The following table summarizes the most important do's and don'ts you should consider before, during and after you apply for a mortgage.



### Before you apply for a mortgage

Do's	Don'ts
<ul style="list-style-type: none"><li>• Do remember that the shorter your amortization period is, the more you will save in interest charges.</li></ul>	<ul style="list-style-type: none"><li>• Don't underestimate the extra costs that you must pay when you buy a house. These represent 1.5 to 4 per cent of the price of the home and should be budgeted.</li></ul>
<ul style="list-style-type: none"><li>• Do remember that adding a few dollars to your regular payment may save you thousands of dollars in interest charges and reduce your amortization period.</li></ul>	<ul style="list-style-type: none"><li>• Don't underestimate a small interest-rate difference between offers. A small difference may have a major impact on the interest you pay in the long run.</li></ul>
<ul style="list-style-type: none"><li>• Do keep in mind that the pre-approved loan may overestimate what you can actually afford to pay.</li></ul>	<ul style="list-style-type: none"><li>• Don't compare offers made to you based on the interest rate only. Compare offers using the Annual Percentage Rate (APR) which – in addition to the interest rate – includes all other fees related to your mortgage.</li></ul>
<ul style="list-style-type: none"><li>• Do keep in mind that changes in interest rates may substantially increase your housing costs when you renegotiate your next term.</li></ul>	<ul style="list-style-type: none"><li>• Don't forget that the financial institution may guarantee you an interest rate 60 to 120 days before you actually take out your mortgage. This may protect you from any increases that may occur during this period.</li></ul>
<ul style="list-style-type: none"><li>• Do request a copy of your credit file before starting to shop around for a mortgage.</li></ul>	

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## Your responsibilities

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### Do's

- Do know your financial situation and how much you can afford to pay before starting to shop around for a house and a mortgage.
- Do shop around to obtain the product that best suits your needs.
- Do read and make sure you understand the terms and conditions of your mortgage contract.
- Do ask questions to help you better understand your contract.

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### Don'ts

- Don't accept the first offer made to you. Although it can, in the end, represent the best choice, make sure you have explored other offerings in order to make an informed decisions.
- Don't limit your shopping to one single financial institution or mortgage broker. To find the best product, you should visit many financial institutions and mortgage brokers.
- Don't skip a payment. This may affect your credit rating and put you in a bad position, as you will have to keep up in the future and absorb higher interest charges.

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## Your rights

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### Do's

- Do know your rights.
- Do keep in mind that all federally regulated financial institutions must specify in your mortgage contract the nature and the amount of all interest and non-interest charges.

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### Don'ts

- Don't forget that federally regulated financial institutions must provide you with specific information before you sign a mortgage contract.
- Don't forget that a federally regulated institution cannot apply undue pressure on you to buy another product as a condition for accepting your mortgage application.

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## After you have applied for a mortgage

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### Do's

- Do take advantage of the different options available to you to pay your mortgage off faster without any penalty, if you can afford it.
- Do you remember that your contract may enable you to minimize the penalty charges (lump-sum payment or blend-and-extend option) if you want to break your mortgage before the maturity date.

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### Don'ts

- Don't wait until you want to break your closed mortgage contract to find out that penalties may be imposed by your financial institution for doing so. You should know, from the beginning, that such penalties exist and how they are calculated.
- Don't wait for your financial institution to contact you at the time of renewal. Keep an eye on the interest-rate fluctuations over the term of your mortgage and start shopping for a new mortgage about four months prior to your renewal date.

## Who is FCAC?

We are the **Financial Consumer Agency of Canada (FCAC)**.

The Government of Canada set up the Agency to protect your rights as a consumer and give you information about the financial products and services you use.

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### *Information*

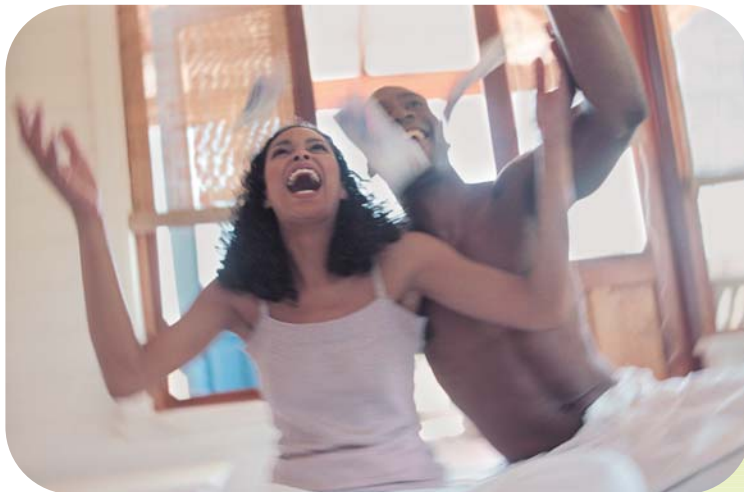
Through our Consumer Contact Centre and publications, we provide user-friendly information to inform you of your rights and help you shop around for the financial products and services that meet your needs.

When we provide information, we do not favour any product or service. We give you the facts that will help you choose the products and services that are best for you.

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### *Protection*

We also make sure that financial institutions that are regulated by the federal government, such as banks and trust and loan companies, respect the laws of Canada that protect consumers. We monitor them to ensure they follow their own voluntary codes of conduct and respect their public commitments. You can obtain more information on the financial institutions we regulate and the laws that apply to them by contacting us.







### *How to Contact Us*

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Ottawa, ON K1R 1B9

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**All of our information and services  
are available free of charge.**