

The Knowledge Resource for Mortgage Funding



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Mortgage Basics

Simply put, a mortgage is a loan you take out to finance the purchase of your home. It is also a legal contract stating that you promise to pay back the loan on a monthly basis. Your monthly payment typically goes toward interest, taxes and insurance as well as the principal.

There are several varieties of mortgages. Fortunately, there are just a few basics you need to know in order to understand most of them.

Fixed-rate mortgages have a fixed interest rate for a specified period of time, generally known as the “term.” The advantage of a fixed-rate mortgage is that your monthly payment never changes over the term. The disadvantage is – if interest rates fall below your fixed rate and you want to lower your rate and consequently lower your payment – you will have to refinance.

Variable-rate mortgages (VRMs) start with a lower rate than a fixed-rate for an introductory period – typically 1, 3, or 5 years – after which the rate adjusts (usually annually) based on a pre-determined index. A VRM is a good choice if you are expecting to live in your home for less than five years, and VRMs can also help you qualify for a larger loan.

The **amortization** of your mortgage is how many years you have to pay back the loan. Most mortgages are amortized over 15, 20 or 25 year periods.

How much should you put down? The down payment is the difference between how much you borrow and the purchase price of your home. And, in spite of what most people think, you do not need a big down payment to buy a home.



Getting Pre-Qualified

Reasons to Get Pre-Qualified:

- With pre-qualification, you have plenty of time to determine which loan program best fits your needs and which programs you qualify for (list of loan programs to follow).
- You will know exactly how much you are qualified for. It is no fun to find the ideal home and then find out you cannot afford it.
- Your monthly payment will be set. This will allow you to budget your money before making this large investment.
- You will learn what the down payment and closing costs will be.
- If you are a first-time buyer, you may be able to qualify for a special program which may expand your buying power by giving you a lower rate or supplementing your down payment.
- If you feel that you can afford a higher mortgage payment but are not able to meet qualifications, co-mortgagor financing may be available to you.

Most Real Estate Professionals and Lenders recommend that home buyers get pre-qualified with a lender before selecting a home to purchase. This way you will have the best information about your price range.

Types of Loans

Adjustable Rate Mortgage	With an adjustable rate mortgage, both the interest rate and the monthly payments rise and fall with market conditions.
Balloon Payment Loan	A loan that becomes due and payable at the end of a certain term. The final payment is larger than the preceding payments and pays the note in full.
Buy-Down Loan	Buy-down loans are loans where the interest rate and the payment are reduced for a specific period of time by paying the interest upfront to subsidize the lower payment.
CMHC Flex Down Program	This Canada Mortgage and Housing Corporation product helps qualifying home buyers who lack a cash down payment, by allowing them to obtain the minimum 5% down payment from virtually any source, including lender incentives and borrowed funds.
Conventional Loan	Conventional loans are sometimes more lenient with the appraisal and condition of the property. When you are buying a “fixer upper,” you may need to use a conventional loan. Homes purchased without mortgage insurance are usually financed with conventional loans.
Fixed-Rate Loan	A fixed-rate loan has one interest rate that remains constant throughout a specified number of years.
Graduated Payment Mortgage	A flexible payment loan that has payments starting lower than a standard loan and increasing by a predetermined amount each year for a set number of years.
Non-Qualifying Loan (Assumable)	Non-qualifying loans are preexisting loans which can be assumed by a buyer from the seller without going through the qualifying process. The buyer pays the seller for his or her equity and then starts making payments.
Variable Rate Mortgage	Variable rate mortgages have fixed payments, but the interest rate fluctuates based on market conditions. The changing interest rate determines how much of the payment goes toward the principal.

The Loan Process

Pre-qualification/Interview

- Application interview
- Lender obtains all pertinent documentation

Order Documents

- Credit report, appraisal on property, verifications of employment, mortgage or rent, and funds to close, landlord ratings, preliminary title report

Loan Submission

- The loan package is assembled and submitted to the underwriter for approval

Documentation

- Supporting documents come in
- Lender checks on any problems
- Requests for any additional items are made

Loan Approval

- Parties are notified of approval and conditions prior to documentation

Documents Are Drawn

- Loan documents are completed and sent to settlement agent
- Borrowers come in for final signatures

Funding

- Lender reviews the loan package
- Funds are transferred to settlement agent

Recording of Documents

- The deed is registered at the local recorder's office
- The closing is now officially completed



Points Explained

What is a point?

One point is equal to 1% of the loan amount.

Why do lenders charge points?

Because it increases the profit earned on the loan. There is a direct relationship between number of points and interest rate. For example, if you pay four points, your rate might be 8%. But if you agree to pay only one, the interest rate might be 8.75%. The general rule is the more you pay upfront, the lower your rate.

Are points called by different names?

Yes: loan origination fee, commitment fee, discount fee, mortgage broker fee, etc.

Who must pay the points?

Points can be paid by the buyer, the seller, or split between the two. Should be stated on contract of sale!

If the seller agrees to pay, your down payment will affect how much of the closing costs a seller can pay.

If you put less than 10% down, the seller can only contribute 3%.



Should points be paid upfront to lower the interest rate?

It depends. Generally, paying one point lowers the interest rate on a fixed-rate loan $1/4\%$. Typically, it takes approximately 5 years to recoup the cost of each point paid provided each point lowers your rate $1/4\%$. Paying points upfront can be a good option if you plan on being in the home longer than the time it takes to recoup the costs of the points (break even). If not, it might be better to take the points.

Is there any way to lock in an interest rate?

Yes. You can obtain a contract from the lender guaranteeing you a specified interest rate for a set time period. The length of time is typically between 60 and 120 days. If you believe you are obtaining a favourable rate, you will want the lock to stay in effect until closing.

Can paying points be avoided altogether?

It can depend on the market. You can often find lenders who will provide you a mortgage without paying points in a market where interest rates are low or in a market where lenders must compete intensely for sales. Whatever the market, it is a good idea to shop around because the fees that are negotiable vary from lender to lender.

What's the importance of APR (Annual Percentage Rate)?

Knowing the APR can help you shop for mortgages. The APR of a mortgage is generally higher than the note rate because the APR includes the interest rate plus related costs such as points, fees for processing the loan and other pre-paid charges. The APR can be used to compare the actual cost of different types of mortgages.



The Appraisal

Having an idea of what is involved in appraising a piece of property can greatly help the seller arrive at a fair asking price and the buyer determine what to offer. An appraisal consists of several steps. The following are the major steps in the process:

1. Research the property as to size, bedrooms, baths, year built, lot size, condition, and square footage.
2. Gather data of recent sales in the neighbourhood. The appraiser needs to locate similar-sized homes which have sold and closed in the neighbourhood. The homes should be as near the subject as possible and have sold within the past six months. These homes are considered the “Comparable Properties,” or “Comps” for short.
3. Field inspection consists of two parts: first the inspection of the subject property, and second, the exterior inspection of the comparable properties.

The subject inspection consists of taking photos of the street scene, front of the home and rear of the home, which may include portions of the yard. The appraiser will make an interior inspection for condition, noting any items that would detract from or add to the value of the home. He will also draw a floor plan of the home while doing the inspection.



The inspection of the comparable properties is generally limited to an exterior inspection. For features that cannot be seen from the street, the appraiser has reports from Multiple Listing Services (MLS), local records, and appraisal files along with other sources to help determine the condition and amenities of the comparables. After the field inspection has been completed, the appraiser must determine which comparable properties most resemble the subject, making slight adjustments in value for any differences between them. After making the required adjustments, the appraiser must go through the reconciliation process with the comparable properties to determine a final estimated value. This method of estimating value is called the “Direct Comparison Approach to Value,” and it usually serves as the foundation for determining the value of single family homes.

It is important to consider that the appraiser will be taking photos of the street scene and of the front elevation of the subject. The street scene gives the lenders some idea as to the type of neighbourhood in which the home is located. The photo of the front of the home gives the lender an idea of its condition and its curb appeal. And lastly, a photo of the back of the home and part of the rear yard is taken. Many homeowners do not take care of the rear portion of their homes and backyards, so for this reason the rear photo is required.

In most cases, the condition of the exterior of a home is indicative of the interior.

An appraiser will call in advance to set up the appointment to inspect the home. At that time, any information about recent improvements or additions to the home should be provided.

In order to facilitate the transfer of property from one owner to another, the best settlement agents will:

- Prepare, review and/or revise closing instructions.
- Ensure that the legal ownership and status of the property has been determined through a “title search.”
- Request a beneficiary’s statement if a debt is to be assumed by the buyer.
- Confirm property meets requirements imposed by lender and/or buyer.
- Prorate all related financial matters (e.g., taxes, insurance) involved in the ownership transfer.
- Ensure all legal documentation is complete, including recording deed.
- Comply with time limits imposed in instructions.
- Close transaction when all instructions (buyer’s, seller’s and lender’s) have been fulfilled.
- Disburse funds as instructed, including all related fees (title fees, commission if any, payoffs, etc.)
- Prepare final closing statement for all concerned parties.

Settlement Agent

You may have heard phrases such as “the house fell out of escrow,” or “we are waiting for escrow to close.” So just what is escrow anyway? And what does it mean to a home buyer or seller?

Simply stated, escrow is the involvement of an impartial third party in a real estate transaction. This neutral third party, a settlement agent, acts as an intermediary between the buyer and seller, collecting and holding money and documents in escrow. Buyer’s funds are deposited with the agent, who then remits to the seller on the buyer’s behalf. The basic concept of escrow is to ensure that both the buyer and seller are protected during any real property transaction. Escrow closes when all of the conditions of the transaction have been met and the title of the property is transferred to the buyer.

Closings can be performed by banks, attorneys, notaries (Quebec), brokers and title companies, as well as independent escrow firms, with all funds being kept in trust accounts. Pertinent regulations help ensure that settlement agents are properly managed and act as truly impartial parties to any real property transaction.

Settlement agents are generally held liable if any instructions are violated during the course of a closing. No changes may be made to any closing instructions if changing them would be detrimental to any party involved. It is possible to change instructions once a property has “entered escrow,” however, only by mutual agreement. Finally, all closings have clearly defined time limits. If, for some reason, all instructions cannot be carried out by the end of the time limit, all parties involved are entitled to the return of documents, fees, funds and other related materials. They also may mutually agree to extend the time period by changing the instructions.

The term “escrow” has come to mean “neutral protection” for the seller, the lender and the buyer. All parties involved in the transfer of real property are impartially protected during the transaction, and are serviced by professionals intent on ensuring a smooth, trouble-free sale. Look for a settlement agent that clearly defines the services offered and lists all fees and charges upfront.

Escrow is an indispensable necessity in today’s marketplace. If you need further explanations during the process, always consult your settlement agent. The settlement agent is, indeed, a neutral third party whose job is to make sure all sale conditions are met quickly and efficiently.

Who Pays What

The SELLER can generally be expected to pay for:

- Real estate commission
- Document preparation fee for deed
- Documentary transfer tax
- Any city transfer/conveyance tax (according to contract)
- Loan fees if required by contract
- Payoff of mortgage balance on subject property
- Interest accrued to lender being paid off
- Statement fees, reconveyance fees and prepayment penalties
- Pest inspection (according to contract)
- Pest work (according to contract)
- Home warranty (according to contract)
- Any judgements, tax liens, etc., against the seller
- Tax proration (for any taxes unpaid at time of transfer of title)
- Any unpaid homeowner's dues
- Recording charges to clear all liens of record against seller
- Any bonds or assessments (according to contract)
- Any delinquent taxes
- Notary fees
- Settlement agent fees
- Title insurance premium

The BUYER can generally be expected to pay for:

- Title insurance premium upgrade
- Settlement agent fee
- Document preparation (if applicable)
- Notary fees
- Recording charges for all documents in buyer's names
- Pest inspection (according to contract)
- Tax proration (from date of acquisition)
- Homeowner's transfer fee
- All new loan charges (except those required by contract for seller to pay)
- Interest on new loan from date of funding to 30 days prior to first payment date
- Assumption/change of records fees for takeover of existing loan
- Beneficiary statement fee for assumption of existing loan
- Inspection fees (roofing, property inspection, geological, etc.)
- Home warranty (according to contract)
- City transfer/conveyance tax (according to contract)
- Property insurance premium for first year

Yours or Theirs - The Personal vs. Real Property Dilemma

The distinction between personal property and real property can be the source of difficulties in a real estate transaction. A purchase contract is normally written to include all real property; that is, all aspects of the property that are fastened down or an integral part of the structure. For example, this would include light fixtures, drapery rods, attached mirrors, trees and shrubs in the ground. It would not include potted plants, free-standing refrigerators, washer/dryers, microwaves, bookcases that are not built-in, swag lamps, etc. If there is any uncertainty whether an item is included in the sale or not, it is best to be sure that the particular item is mentioned in the purchase agreement as being included or excluded.

Glossary of Mortgage Terms

Adjustable/Variable Rate Mortgage Loans (ARM/VRM): A mortgage that offers a low interest rate for 1, 3, or 5 years, after which the interest rate adjusts periodically based on a pre-determined index.

Amortization: The gradual reduction of debt over the term of the loan. Amortization occurs through repayment of principal.

Annual Percentage Rate (APR): The yearly cost of a mortgage including interest and other expenses, such as mortgage insurance and points, that are spread over the life of the loan.

Appraisal: A written estimate of a property's current market value.

Closing: The conclusion of your real estate transaction where legal documents are reviewed and funds are disbursed.

Closing Costs: Expenses over and above the cost of the property and can include items such as title insurance, appraisal, processing, underwriting and surveying fees.

Conventional Loan: Loans that are not made under any government-housing program.

Credit Report: A report from an independent agency detailing credit history and previous and current debt to help determine creditworthiness.

Credit Score: A mathematical formula that predicts an applicant's creditworthiness based on credit history, outstanding debt, type of credit, bankruptcies, late payments, collection judgments, extent of credit history and number of credit lines.

Deed: The legal document that transfers property from one owner to another.

Down Payment: The amount of your home's purchase price that you pay upfront.

Earnest Money: Deposit made by a buyer toward the down payment to show good faith when the purchase agreement is signed.

Equity: The difference between the current market value of a property and the total debt obligations against the property. On a new mortgage, the down payment represents the equity in the property.

Good Faith Estimate: Written estimate of the closing costs the borrower will likely have to pay to obtain the loan.

Interest Rate: The percentage rate that a lender charges to borrow money.

Lock or Lock-In: A lender's guarantee of an interest rate for a set period of time. The lock-in protects you against rate increases during that time.

Mortgage Insurance: Insurance to protect the lender in case the borrower defaults on the loan. With conventional loans, mortgage insurance is typically not required with a down payment of 20% or more of the home's purchase price.

Points (or Discount Points): Points are upfront fees paid to the lender at closing. One point equals one percent of your total loan amount. Points and interest rates are inherently connected. The more points you pay, the lower your interest rate.

Principal: The balance — not counting interest — owed on a loan.

Term: The length of time the interest rate is fixed.

Title: Legal ownership in a property.

Title Search: Examination of public records to ensure that the seller is the legal owner of a property and that there are no liens or other claims against the property that would prevent a transfer of ownership.

Underwriting: In mortgage lending, the process of determining the risks involved in a particular loan and establishing suitable terms and conditions for the loan.

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