When Jason Scott went to the bank to get his first mortgage, $89,000 seemed like a staggering debt. The young freelance photographer knew little about fixed or variable rates, amortizations, or repayment strategies that could impact the long-term cost of owning a home. For years afterward, he wondered if he had received good advice or had asked the right questions.

Now as an experienced mortgage broker, Jason is dedicated to helping homeowners find the best mortgages for their needs and budgets. Whether you're a first time buyer or hoping to soon retire, this easy-to-read book provides insight into the complicated Canadian mortgage landscape.

DISCOVER
- How to avoid costly financing mistakes
- How to save money when renewing your mortgage
- What you need to know if you're self-employed
- What to do when the marriage ends
- The truth about reverse mortgages
- When to refinance to save money

JASON SCOTT is an Edmonton-based mortgage broker with TMG The Mortgage Group. For information on his services, visit edmontonmortgagebroker.com

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APPROVED!
Mortgage Advice for All Stages of Life

JASON SCOTT

Pencil drawings by Julie Popowicz
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Dedication

To Catherine, Griffin and Zennen, with my love

To my parents Gordon and Patricia, thank you
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INTRODUCTION

LET’S FACE IT. Personal finance isn’t a sexy topic for most Canadians. And mortgages are the buck-toothed introverts wearing coke-bottle-thick eye glasses at the personal finance party.

People might discuss investments and stocks at a dinner party. They may brag about a quick $5000 profit made from betting on a penny stock. They may read about hot stocks on investing websites, devour the financial section of a paper or buy books on the top 50 mutual funds. But people don’t discuss mortgages at social gatherings or delve into mortgage financing on any level, except maybe to compare rates - which is too bad, considering most Canadians, for much of their adult lives, will carry mortgage debt that outweighs their liquid investments.

I’m a residential mortgage broker. I’m blessed to meet and help regular Canadians get mortgages suitable for their financial situation. Traditionally, financial institutions like banks and credit unions promoted their mortgages in-house, while mortgage brokers assisted individuals or companies in obtaining a mortgage when the conventional avenues were not available. Now, mortgage brokers represent about 27 per cent of all new mortgages and that market share is considerably higher among younger borrowers. Like a real estate agent searching for the perfect home for a client, mortgage brokers seek the best mortgage solution that satisfies the needs of consumers. In Canada, mortgage brokers are most often paid by the lender, and
are licensed and regulated to ensure compliance with banking and privacy laws.

Whether it’s a downtown condominium, a heritage property or a renovator’s dream in the suburbs, deciding to take the plunge into home ownership can be an overwhelming experience. I’ve written this book to provide a basic understanding of mortgage options and to guide readers through the process of buying or refinancing a home.

I want to make a decidedly dry topic accessible and interesting for the average Canadian. From the excitement of buying a first home or the rewards of retirement, to the despair of marital breakdown, each chapter tells a story about an individual or family who needs help with decisions about their mortgage. The characters in this book, except for my relatives, are all fictional, but the stories reflect typical, real life situations.

This edition of the book was completed in early 2015 and all information is based on the existing mortgage lending environment. Lending rules and programs change frequently and updated editions will be published to reflect those changes. The book doesn’t delve into all the nuances that homeowners may encounter in securing a mortgage but it does provide basic, solid information that applies to most readers.

Next time you’re at a party, consider having a quick conversation about mortgages. You might find that the introvert with the coke-bottle glasses is really interesting.
CHAPTER 1
First Time Buyers
IT WAS A PERFECT SUMMER EVENING. Puffs of cumulus cloud lingered in a crayon blue sky and the smell of freshly cut grass mingled with bratwurst and burgers.

My wife, Catherine, and I like to entertain and our family home, nestled in a quiet river valley neighbourhood near downtown, is the perfect spot for gatherings with friends and colleagues.

“Your place is great,” said my buddy, Dave, helping himself to an ice-cold drink. “Tessa and I are tired of renting. We like our townhouse but we’ve paid all this money in rent over the past couple of years and we’re not building anything for the future.”

“No kidding,” added our friend Annette. “We’re renting an old house and I hate our kitchen! New countertops and some updated paint colours would make a huge difference but my landlord won’t make any changes. And who wants to spend money on renovations for a house you don’t own?”

“Chloe wants a dog but the landlord won’t give us permission,” piped up Garrett. “And we just got a letter saying our rent is going up another $100 a month. If we’re going to have to move, I want to move into a place I own.”

Our friends are like most young couples in Canada. They have started their careers, are in serious relationships and want to settle down and buy a first home. Homeownership really is the Canadian dream and the numbers prove it.

About 450,000 existing homes were sold each year between 2008 and 2013, according to the Canadian Real Estate Association, the national real estate agent association that operates the MLS...
system. Those sales numbers don’t include new homes bought directly from builders or private sales where real estate agents weren’t involved. Real estate and mortgage financing are big business in Canada and are key drivers of the country’s economy.

According to a survey by the Canadian Association of Accredited Mortgage Professionals, which represents mortgage brokers, lenders and other stakeholders, there are about 13.8 million households in Canada. Of this number, 9.52 million are homeowners. Just under six million have mortgages and almost four million that are mortgage free.

Of those who have mortgages, about 1.65 million also have a home equity line of credit, commonly called a HELOC. Another 650,000 don’t have mortgages but owe money on their HELOCs. All those loans add up to about $1.2 trillion in debt as of January 2015.

“Tessa’s been looking at online house listings for a couple of months now,” said Dave. “We went to see a cute bungalow last week that was fantastic. It had original hardwood floors and these huge widows that let in lots of light. It’s awesome and she’s totally fallen in love with it. I want to make her happy but I have no idea if we can buy it.”

That’s a common story. Shopping for the perfect home and imagining a terrific, new lifestyle is exciting. Most first time home buyers have an idea of the type of property or neighbourhood that fits their lifestyle but they know little about down payments and closing costs, fixed rate versus variable rate mortgages or how amortizations and repayment strategies impact the long-term
cost of owning the home.

Getting your financial house in order should be step one in purchasing a home. A mortgage pre-approval lets you know before you begin to shop if you can qualify for a mortgage and how much money you can borrow.

I told my friends that a mortgage broker or banker needs to know a client’s income, credit score and monthly debt payments on student and car loans and personal lines of credit and credit cards balances.

Two formulas are used to determine how much a person can borrow for their mortgage. The first calculation is called the Gross Debt Service Ratio (GDSR). The monthly mortgage payments, property taxes, heating cost and half of the condo fees, if applicable, are divided by the person’s gross monthly income. The ratio has to be less than 35, which means the property costs are less than 35 per cent of the person’s pre-tax income. Clients with excellent credit can have a GDSR up to 39.

The next calculation, called the Total Debt Service Ratio (TDSR), factors in all the property expenses in the first formula as well as the monthly payments on outstanding personal debts. This is divided by the person’s gross income. The ratio must be less than 42, meaning the property expenses and other debt payments are less than 42 per cent of the person’s gross monthly income. Again, clients with great credit get a bit more wiggle room and can have a TDSR up to 44.

“Ugh. Math! Make him stop! My head hurts already,” Garrett joked. “What’s most important, your income, your debts, your
credit history or your down payment?”

“They’re all interconnected,” I replied. “Being weaker in one area won’t necessarily cause your application to be declined, if the other areas are strong enough to compensate. It depends on the overall picture.”

I explained that banks are in business to lend out money and collect interest payments on the loans. They don’t like to lose money and are cautious about whom they approve for a mortgage. Underwriters - the people who decide whether to approve or decline a mortgage application - judge the pros and cons of each application. If the risk of the borrower defaulting on the loan is low enough then the mortgage application will be approved.

For younger buyers, credit history or sometimes the lack of credit history, is likely the single biggest obstacle to getting the green light for a mortgage. Lenders want to see a reasonably well-established track record of debt repayment on other loans to get a sense of a person’s character and credit worthiness before they’ll lend several hundred thousand dollars.

Credit scores range from 300 to 900 and are used by lenders to predict how likely a borrower is to default on loans in the future. The lower the score, the greater the risk the person won’t pay his debts.

Car loans, student loans, credit cards, retail store cards, lines of credit and buy-now-pay-later loans are some examples of loans reported to credit bureaus. There are two major credit bureau companies in Canada. They are Equifax and TransUnion
and lenders will check an applicant’s credit history at one or both companies. It is possible to have different credit scores with each company.

“Enough talking about work!” my wife, Catherine, interrupted, handing me a fresh tray of sushi.

“Oh, sorry guys…. I tend to get carried away about this stuff,” I said sheepishly.

“Actually, this is interesting,” said Annette, reaching for an avocado roll. I was told my credit was 710 once but no one has ever told me how credit scores work. What else do we need to know?”

“How you handle your credit is a major factor on whether you can get a mortgage and, assuming you can get approved, can impact your interest rate,” I said.

A credit score is based on five factors.

*Past payment history* is the single most important factor because it shows financial discipline and good character. If you’ve always made your payments on time, chances are you’ll do the same in the future. No one is perfect so if you are accidentally late on a payment or two over a couple of years, your score will not be greatly impacted. Credit bumps like late payments will disappear from your credit history in time.

“Yeah, a couple of years after graduating, I spent six weeks backpacking in Europe and I missed a payment on my student loan,” said Garrett. “The person who handled my car loan last year said it was still showing. That’s annoying. I’m not a deadbeat.”

“Hey, one late payment isn’t the end of the world,” I replied.
“It’s far more serious if you have a collection reported on your bureau. I’ve seen people get a collection because they moved cities and a final cable bill went to their old address. They didn’t know about the outstanding bill and eventually the bill went into collection. It had a significant impact on their credit score and had to be paid before they could get a mortgage.”

The second most important factor that influences a credit score is *how much of your available credit is being used*. Owing money doesn’t make you a credit risk. Owing money on many credit cards and other accounts may show you’re overextending yourself and are more likely to make late payments or not pay at all. The closer you get to ‘maxing out’ a loan, the bigger the hit your credit score takes. Being over the limit on a credit card really knocks a score down. Ideally, the amount you owe will be less than 75 per cent of the loan limit.

“You won’t believe this but it’s possible to have an excellent credit score, and not have good enough credit to get a mortgage,” I said slyly.

“What? How is that possible?” Chloe asked.

“A credit report tells a lot about a person’s character – at least about being responsible to pay debts on time,” I explained. “Many young people only have a credit card with a $500 limit. They may pay the card off every month and because of that they will probably have an excellent credit score. But lenders call this a false score.”

Mortgage lenders typically want to see that a person has two credit accounts each with a two-year history. If a person doesn’t
have an *established credit history*, it’s common for the lender to ask for a co-signer on the mortgage application. Some lenders will allow for alternative proof of credit history in the form of a letter of support from a landlord or proof that utilities such as cable or cell phone accounts have been properly paid for at least a year.

“What if I want to get a line of credit from my bank?” asked Annette.

*Seeking new credit* impacts a credit score as well. A ‘hard inquiry’ happens when a potential creditor pulls a person’s credit history to see if a loan should be granted. Having your credit pulled many times over a year will impact your score, especially if a new loan is taken each time as this is perceived to be riskier behaviour. On the other hand, ‘soft inquiries’ such as pulling your own credit history don’t hurt your score.

The *type of credit* in use has a bearing on a person’s credit score. The credit bureau companies look at the mix of credit card, retail accounts, installment loans and other types of credit in use as well as the total number of outstanding loans.

“We should sit down with you and see where we stand,” said Dave, as Catherine waved us into the dining room.

Two weeks later Dave and Tessa gave me a call.

“Tessa and I are getting pretty serious about buying a house,” Dave began. “We’re really interested in the one I was telling you about at the party but things have changed a bit.”

“We’re pregnant!” Tessa gushed. “I’m only 12 weeks along so we haven’t told anyone yet, not even our parents. We don’t
want to have a baby in our one-bedroom apartment. And there’s no elevator. How are we going to juggle a baby, groceries, and a carriage on all those stairs?”

“We don’t know if we can swing it though,” Dave added.

“Congratulations!” I told them. “I’d be happy to help. I’ll send you an email with the paperwork I’d like you to bring to the office.”

Dave and Tessa are both employees so the required paperwork was straightforward:

- a recent pay stub for each of them
- an employment letter on company letterhead outlining their full time tenure, position, hourly wage and the guaranteed number of hours they work each week
- a 90-day history of the account for their down payment money: personal chequing or savings bank accounts, Tax Free Savings Account or Registered Retirement Savings Plan statements
- a void cheque for the bank account from which the mortgage payments will be automatically withdrawn

Later that week, Dave and Tessa arrived at the office to talk about their financial situation and their house shopping plans.

“The first thing we should do is fill in a pre-approval application,” I said. “I’ll ask you all sorts of questions including your social insurance number and birthday. I’ll also need to know some details about where you’ve lived and worked for the past three years and a list of your assets like savings, investments and vehicles. Then I’ll pull your credit to see what you owe on
your loans and what the required payments are, and to make sure everything looks good on the report.”

“Wow, do you want a pint of blood and a DNA sample too?” Tessa asked. “I already gave at the hospital.”

“Sorry Tessa, but it’s better to get all this information up front so the pre-approval is based on accurate information. You don’t want to spend time searching for a house, fall in love with a place and have your heart broken because something was missed.”

The first topic of discussion was whether Dave and Tessa had a down payment. I explained that they needed at least five per cent of the purchase price for the down payment and an additional one and a half per cent to cover closing costs like legal fees and land transfer taxes.

Down payments can come from accumulated savings. A first time home buyer can withdraw up to $25,000 from a Registered Retirement Savings Plan. The money has to be repaid to the RRSP over the next 15 years or penalties apply.

Another common source of down payment funds is gifted money from immediate family members. The money must be a true gift and lenders will ask both the giver and the receiver to sign a gift letter. Often the lender will ask for bank statements showing the money being transferred from one account to the other.

“We have $24,000 between our RRSPs, my Tax Free Savings Account and a joint savings account,” Tessa explained. “Is that going to be enough?”

Based on a sale price of $350,000, Dave and Tessa needed
at least $17,500 for the down payment and another $5250 for closing costs. That brought the total amount needed to $22,750.

“So if we use $17,500 for a down payment, then our mortgage will be $332,500, right?” Dave asked.

“No, not quite,” I responded.

The Canadian government requires mortgage default insurance on any mortgage where the down payment is less than 20 per cent of the purchase price. The premium is based on the down payment as a percentage of the house price multiplied by the base mortgage amount. These mortgages are often called high ratio mortgages. Mortgages that aren’t insured are called conventional mortgages.

The biggest player in the market is Canadian Mortgage and Housing Corporation, a crown corporation that protects banks from losses if homeowners stop paying the mortgage and go into foreclosure. Two other private companies, Genworth Canada and Canada Guaranty, also insure mortgages.

“If you only put down five per cent, then your premium is 3.15 per cent of the mortgage. In your case, since you’d be borrowing $332,500, it works out to $10,473.75. The insurance premium gets added to your mortgage. You could pay it up front but almost no one does,” I explained.

“What? I could buy a motorcycle for that kind of cash!” Dave gasped.

While less than one per cent of all mortgages go into foreclosure in Canada, mortgage rates would be much higher and getting approved would be more difficult if it wasn’t for mortgage
default insurance.

In recent years, the federal government repeatedly tightened mortgage default insurance rules in a bid to prevent a Canadian version of the housing price bubble that sideswiped the United States.

House prices increased dramatically in Canada between 1998 and 2012 and politicians were afraid of a crash that could devastate Canadian families and the economy. Many of the Canadian rule changes were aimed at first time home buyers and were meant to prevent them from taking on too much mortgage debt.

Low mortgage rates and their accompanying affordable monthly payments encouraged young buyers to stretch for more expensive homes and further push up home prices. In one series of rule changes, maximum amortizations – the number of years it takes to pay off a mortgage – were repeatedly reduced from 40 years to 35 to 30 and finally 25 years. Each five-year reduction pushed up minimum monthly payments, much like an interest rate hike would. One positive of shorter amortizations is that homeowners pay more on their balance with each payment.

It took about 10 minutes to fill out Tessa and Dave’s application and pull their credit reports. Their credit scores were excellent; they weren’t carrying debt other than a car loan with $350 monthly payments.

I calculated their Gross Debt Service Ratio which is based on house-related costs divided by pre-tax income. I used a house price of $350,000 with a five per cent down payment. The ratio
was low at 28. Next, I calculated The Total Debt Service Ratio - the house-related costs and their monthly consumer debt payments divided by the gross pre-tax income. That number was 33.

“How does it look?” Tessa asked.

“It looks great,” I replied. “Your ratios indicate you can easily afford the house; you have great credit and you have a down payment. You are financially ready to make an offer on the property.”

“Really? Oh goodie!” Tessa beamed. “This is so exciting.”

I outlined how I’d submit a pre-approval application to a lender and get a 120-day rate hold for them. As long as they took possession of a house within 120 days, Tessa and Dave would be guaranteed their rate, even if rates increased during the rate hold period.

“That way, if the house you have your eye on doesn’t work out, you can take your time finding another option,” I said.

We spent some time reviewing their various mortgage options including different mortgage types, terms and the effect of amortization periods on payments and total interest costs.

Typically, first-time home buyers are encouraged to choose a fixed-rate mortgage because the interest rate and the payment stay the same over the term of the mortgage. This stability makes it easier to budget for the payments.

“Fixed rate mortgages let you sleep well at night,” I said. “It’s like insurance. But you need to know you’re paying a bit of a premium for that peace of mind.”

Historically, homeowners usually save money by taking
variable rate mortgages rather than fixed rate mortgages but that isn’t always the case.

With a variable rate mortgage, the mortgage rate and the payment changes whenever the lender’s prime rate changes. The prime rate is based on the Bank of Canada’s key interest rate. This rate is lowered when the Governor of the Bank of Canada feels the economy is slowing and needs a kick start. The Bank of Canada increases the rate when it wants to slow the economy and keep inflation in control.

Tougher underwriting rules introduced in 2012 dictate that clients who want a variable rate mortgage or a fixed rate with a term less than five years must qualify at the Bank of Canada’s qualifying rate, which in early 2015 sat at 4.79 per cent.

Clients choosing fixed rates of five years or longer qualified at the mortgage’s contract rate.

The rule was instituted to make sure that homeowners with extremely low short-term mortgage rates are able to afford their mortgage at renewal if rates are significantly higher.

“What’s the difference between the term and the amortization of a mortgage?” Dave asked.

“Great question. People often get confused by that especially if they happen to come across a US website where mortgage terms are often 25 years long,” I replied.

The term is the length of the mortgage contract before it comes up for renewal and a possible rate change. Terms typically range from one to 10 years. The most popular term for mortgages in Canada is five years.
The amortization is the number of years it will take to completely repay the mortgage. Amortizations on insured mortgages are typically 25 years, although 30 years is possible if the mortgage is conventional rather than insured. There are a couple of lenders that allow 35-year amortizations.

“Are you working with a real estate agent?” I asked. “If not, I can introduce you to one.”

“Yes, the sister of a friend of mine is an agent,” Tessa said. “She seems really eager to help us negotiate a great price.”

“Okay, once you have an accepted offer I’ll contact the real estate agent to get a copy of the purchase contract and the MLS listing,” I said.

I also told them that the lender would need to know the name and contact information for the lawyer handling their transaction in order to send mortgage instructions. I took a look at Dave and Tessa’s bank statements to make sure they had enough for their five per cent down payment and the one and a half per cent typically needed for closing costs.

Dave and Tessa had brought their employment letters. I reviewed the letters to make sure they were on company letterhead and that the letters stated their full time position, their hourly wage and guaranteed number of hours per week. Tessa is salaried so her letter had to state her annual salary. Both letters were to be signed and the signatore’s phone number supplied so the bank could call to confirm the information.

“These look good,” I said. “The lender will need a void cheque in order to set up automatic withdrawals from your chequing
account."

“You mean we can use any account we want? We don’t have to open up a chequing account at the bank that holds our mortgage?” Tessa asked.

“No, the lender will be happy to take your money even if it’s coming from one of its competitors,” I said.

“I’ll get you a cheque,” Tessa said. “I thought for sure we’d have to open a new account.”

“Okay, other than the cheque, you’re all set to make an offer on a home,” I said.

I reminded Dave and Tessa that it was important to have a clause in their contract saying the purchase was ‘subject to satisfactory financing.’ This meant that they could ask for five to 10 days to get their mortgage financing in order. The clause gave them the ability to back out of the purchase if they couldn’t get financing. This also protected them in case the lender and mortgage default insurer felt the purchase price was higher than the property’s market value.

“Good luck guys! Let me know how the negotiations go.”

A few days later my phone rang. Dave was on the other end.

“Good news, man! The offer we made on the house was accepted by the sellers late last night. What do we need to do now?”

“Hey, that’s great,” I replied. “You just need to decide whether you prefer a fixed or variable rate and I’ll get a copy of the MLS listing from your realtor.”

“We’ve made up our mind and we’re going to play it safe by
going with the fixed rate,” Dave said. “We know we’re going to pay more in interest, at least initially, but we’d rather be safe than sorry.”

I submitted the completed application to the lender which had the best solution for Tessa and Dave. The rate was competitive and the lender gave its clients generous pre-payment privileges. This would permit Tessa and Dave to increase their payments as well as make extra payments, allowing them to pay their mortgage down faster and save thousands in interest.

The next day I received a commitment letter from the lender. This meant Dave and Tessa’s application was approved and they would get a mortgage to buy the house if they could satisfy the usual conditions of proof of income and down payment. I had submitted those documents to the bank at the same time as submitting the application but banks typically take a few days to review the paperwork. Even though the conditions were still outstanding, I was confident that they would be fully approved and Dave and Tessa could remove their financing condition in the next few days.

I met with Dave and Tessa to review the commitment letter and the terms of the mortgage.

“We should talk about your payment options because the payment frequency you choose can have a significant impact on your overall mortgage costs,” I said.

There are four common mortgage payment options. These are monthly, semi-monthly, accelerated bi-weekly and weekly payments.
Monthly payments are made once per month for a total of 12 payments per year. Semi-monthly payments are made twice per month for a total of 24 payments per year. Accelerated bi-weekly payments are made every two weeks for a total of 26 payments per year. Those two extra payments per year go directly to paying down the mortgage balance so a 25-year amortization is reduced by a couple of years.

Weekly payments also reduce a mortgage amortization but most people choose accelerated bi-weekly payments to match their employer’s payday schedule.

“You should choose accelerated bi-weekly payments if it fits your budget. You probably won’t notice the extra payments you’ve made over the course of a year and it will knock years off your mortgage and save you thousands of dollars in interest,” I explained.

“That makes sense,” Tessa said. “We can switch back to monthly if we want right?”

“Yes, you can,” I replied.

Dave and Tessa selected accelerated bi-weekly payments, signed the commitment letter, and I sent the document back to the bank.

The following afternoon I received confirmation that the bank was satisfied with Dave and Tessa’s income and down payment documents. I immediately called Dave and Tessa to let them know that they could remove their financing condition.

“Congratulations! You’re all done the mortgage approval process. Your next steps will be to get fire insurance in place, sign
papers with your lawyer and get the utilities set up for the day you take possession.”

“That’s great news,” Dave said. “Thanks for all your help.”

Six weeks later, the mortgage funded and Dave and Tessa had the keys to their bungalow. They walked through each room with a growing excitement - the living room with its welcoming fireplace, the ample master bedroom and ensuite, and the cozy kitchen that would soon become the centre of their home. When they stopped in the baby’s room they both knew that they had purchased more than a piece of property. They had purchased peace of mind for their financial future.
CHAPTER 2
Moving Up
MY HOMETOWN SPROUTED ON THE BANKS of a majestic river surrounded by parkland, ravines and gently rolling terrain. The crown jewel is the 18,000-acre river valley stretching across the city which boasts a network of parks and multi-use trails that are popular with hikers and cyclists. One Saturday, I decided to escape my office and enjoy a bike ride in the exquisite, autumn landscape. The morning was crisp. Ice from the first frost clung to the grass and flowers and the tree canopy was dusted with a halo of ruby and gold. Pockets of geese were feeding in the grasses that bordered the trail, and fat, brown squirrels hunted for seeds and nuts in the mat of fallen leaves.

After a morning of exercise, I was hungry too so I cut across a footbridge to the south side of the river and headed to a popular neighbourhood café. As I locked up my bike, I spotted my friend, Andrew. We hadn’t seen in each other in a couple of months so we took our coffees and blueberry muffins to a small table and began to catch up on each other’s busy lives.

“What’s new and exciting?” I asked, before diving into my frothy latte.

“Things are going really well,” Andrew said. “I received a promotion at work a couple of months ago and Stacey has a great new job at an up-and-coming marketing firm. Our incomes have increased and we’re thinking of selling our downtown condo and upgrading.”

“What kind of home are you looking for?” I asked.

“It would be nice to have a basement and a garage. We’re starting to feel a little cramped for space,” Andrew said. “Plus, I’d
like to have a yard, even if it means I’ll have to mow the lawn and shovel snow. I haven’t done those chores since I lived with my parents,” he admitted.

“Well, believe me, by mid-February the novelty will have worn off!” I laughed.

Andrew told me that he and Stacey had owned their condo for 10 years. During that time, property prices had increased and they had paid down some of the principal on their mortgage; in total, they had built up about $155,000 in equity. They now owed $120,000 on the condo, which they intended to list for $285,000 and hoped to sell for around $275,000.

They planned to buy a house for about $400,000.

“You have a couple of options,” I advised. “Obviously, you are thinking of selling and buying but have you ever considered keeping the condo and purchasing a new home?”

Andrew looked puzzled.

“No. How would that work?”

I explained how Andrew and Stacey could refinance their condo to 80 per cent of its value. If the condo appraised at $275,000 they could get a new mortgage on it for $220,000. Their current mortgage balance was $120,000 so they could access about $100,000 for a down payment on a new home. I assumed that a mortgage payout penalty and legal costs on the new mortgage would be between $3000 and $5000.

“You’d keep the condo, rent it out and potentially generate some monthly profit,” I explained. “You’d have some costs but they would be less than what you’d pay a real estate agent to sell
your place."

While it sounded like an interesting idea, Andrew wasn’t sure that he and Stacey wanted to be landlords. They were busy with work and didn’t want to deal with any headaches like broken toilets and bounced rent cheques. They also wanted to minimize the mortgage on their home.

“You have to do what makes sense for you,” I said. “Owning rental property is like owning a business and it’s not for everyone. There is a large learning curve and despite what the late night infomercials say, it’s not a get-rich-quick scheme.”

I explained to Andrew that he and Stacey would probably be able to port their existing mortgage to the new house. If they sold their condo for $275,000 they’d have about $140,000 for a down payment after real estate commissions, legal fees and taxes.

If they bought a $400,000 house, they’d need a mortgage of $260,000. In a porting situation, their existing mortgage balance of $120,000 and existing interest rate would be blended with the extra $140,000 they needed at the current interest rate for the new term they’d choose.

“You’d end up with an averaged rate on the $260,000 but wouldn’t have any payout penalty,” I explained.

Sometimes it makes better financial sense to break the existing mortgage, forfeit the payout penalty and get a whole new mortgage. In recent years, Canadian mortgage rates have fallen dramatically. This is largely because the Canadian economy sailed through the global economic crisis relatively unharmed and is seen as a safe haven for international money.
Foreign investors who are buying Canadian mortgage bonds, mortgage backed securities and Canadian Government long bonds are more concerned about protecting their money rather than generating significant returns. The demand for safety has pushed the yield on Canadian mortgage bonds to historic lows and the benefit for homeowners is rock-bottom mortgage interest rates.

It’s highly likely that over the next few years mortgage rates will increase as the US and European economies recover and start growing again.

“I can crunch the numbers for you to see if it makes sense to break your mortgage,” I said to Andrew. “It really comes down to what your penalty is and how long it will take to break even on the penalty with the lower rate.”

Andrew promised to call his current lender to find out his estimated payout penalty.

I was buying a second round of coffee just as his wife breezed into the café.

“Hi guys,” Stacey said, as she pulled up a chair and joined us. “I’m desperate for a cappuccino. The farmers market is absolutely packed this morning.”

Andrew told Stacey that we had been talking about their home buying plans. She told me that they liked the idea of buying in a mature neighbourhood but figured they’d likely have to do cosmetic renovations to update the home to match their tastes.

“Are you saying you’re not a fan of wood paneling, dusty rose wallpaper or gold linoleum?” I joked.
Stacey responded with a grimace of mock horror.

I explained there were a couple of options to help pay for the renovations if they did want to buy an older home. Depending on the amount of work that needed to be done, they could make a smaller down payment and use their extra money to cover the renovation costs. Alternatively, if they didn’t mind doing renovations over a number of years they could save and pay for projects over time. That was a non-starter with Stacey.

“There’s no way I’m going to live in a construction zone,” she said. “Especially if Andrew thinks he’s doing the work himself. He’s so busy at work right now we’ll be in an old folks’ home before he finished.”

The third option was to roll the cost of the renovations into their mortgage through a purchase plus improvements program. Most lenders allow for homebuyers to add the cost of renovations to the mortgage.

I explained that during the application process lenders ask for quotes for the materials and labour for the planned renovations. The renovation costs are added to the total amount of the mortgage and the amount is sent to the lawyer with the rest of the mortgage money. The renovation money is held in the lawyer’s trust account while the work is completed. The homeowners have to pay for the materials and labour out of their own pocket during the renovation process. When the project is finished, the lender sends an appraiser to the property to confirm the work is complete and the lawyer then releases the renovation money to the homeowners.
“So we have to pay for everything up front? What’s the point of doing it then?” Andrew asked.

I agreed that getting quotes during the tight timelines of a mortgage approval adds extra work and stress to the process but can make sense. The extra steps and the cost of the appraiser to confirm that the renovations are complete are justifiable if the alternative is to pay for renovations with debt that is at a higher rate than the mortgage.

“If you have savings to pay for the renos, then that’s the way to go,” I explained. “But if you’re thinking of charging the cost of the renovations to a line of credit or a credit card, it makes sense to jump through the hoops to borrow the money at a lower interest rate.”

A fresh crowd of diners started pouring into the coffee shop. Two families with strollers were looking for larger tables by the windows, and some singles plunked into a soft sofa, clutching their tablets like our grandparents might have embraced the Sunday paper. I glanced at my watch and saw that it was close to noon.

“I’m sorry to cut this short but I have to get back home and mow the lawn before it snows,” I said. “Andrew, give me a call when you find out what that payout penalty is and we’ll set up a time to figure out the best mortgage strategy for the two of you.”

“Sounds good. Thanks for the information,” Andrew said.

“See you later,” Stacey waved.

A couple of days later my office phone rang. Andrew was on the line.
“I called the bank and they said my payout penalty was $1,833 as of today.”

“That’s pretty good,” I replied. “I’ve seen people who had penalties of $15,000 or $20,000 and it just didn’t make sense to break the mortgage.”

Lenders will describe their mortgages as open or closed. An open mortgage means it can be paid out early without incurring a penalty. A closed mortgage means the lender will charge a penalty for breaking the mortgage by paying it off early.

Closed variable rate mortgages usually have a payout penalty of three months of interest based on the balance of the mortgage at the time the mortgage is paid out.

Homeowners who break a fixed rate mortgage will incur a penalty based on the greater of three months of interest or the interest rate differential (IRD). The IRD is typically calculated by taking the difference between the existing mortgage rate and the current mortgage rate for a new mortgage that is close in term to the remaining term of the existing mortgage. This figure is then multiplied by the balance of the mortgage and the number of months remaining in the current term.

For example, let’s say a client had one year left in a five-year term on a $250,000 mortgage with a five per cent interest rate. If the current one-year rate was three per cent then the IRD could be as much as $8750, depending on the lender. Unfortunately, there isn’t a standard rate that lenders use to base the interest rate differential and as a result, it is difficult for homeowners to calculate potential IRD penalties on their own. IRD penalties can
vary dramatically between lenders, although generally the IRD penalties of the Big Five banks are higher. “Why the heck do they charge a penalty to pay out a mortgage early?” Andrew asked. “They’re just going to loan the money out again.”

“Well, first of all, they do it because they can. It’s their money and you have to play by their rules if you want to use it,” I replied. “The second reason is that many lenders will bundle several hundred mortgages together and sell that bundle of mortgages to an investor like a pension fund that wants guaranteed income on its investment. The lender then takes the money it realized from the sale and lends it out again through new mortgages. This is part of a banking process called mortgage securitization.

When mortgages are paid out early, the monthly income on those mortgages disappears and the investor that bought the mortgages needs to be compensated for that loss.

“You mean my bank might not own my mortgage?” Andrew said.

“Technically, that’s true,” I said. “But from a practical standpoint it has no impact on the homeowner. You won’t know if it’s happened. Life goes on as usual because you’re still making your payments to the lender and they’re your point of contact if you want to change your payments, make extra payments and so on.”

I paused to let Andrew digest all of this new information. “Let me crunch some numbers and I’ll call you back in a few minutes,” I said.
I did some calculations and determined that it would take about eight months to recover the pre-payment penalty. It clearly made sense to get a brand new mortgage rather than blend the mortgage. As painful as it is to give banks extra money, it’s good business if the penalty can be quickly recouped through a lower rate. Getting a new fixed rate mortgage now would protect Andrew and Stacey from the possibility of renewing their existing mortgage in a year at a higher rate.

Later that week, Andrew informed me that he and Stacey were meeting with a real estate agent to list their condo and that they were starting to look more seriously at houses.

“We’d better do a mortgage pre-approval for you so you can have a guaranteed rate while you’re waiting for your condo to sell and you’re shopping for a new home,” I replied.

We filled out the application on the phone. Andrew and Stacey were strong clients who had good paying jobs, excellent credit and a significant down payment. The only potential obstacle would be if their condo didn’t sell.

Two weeks later, I phoned Andrew and Stacey to see if there had been any developments in the condo sale or the home search. Stacey answered on the third ring.

“Andrew and I have been talking and we’re thinking maybe we should buy a new house instead of a fixer upper,” Stacey said. “I’d rather get a big new house now than buy something that we have to renovate and then sell in a couple of years in order to move up the property ladder.”

Many people like the idea of building a new house. The
benefits include putting personal creativity and tastes into the project and potentially avoiding significant maintenance expenses for a number of years.

“There are a couple of things you need to know about getting a mortgage on brand new home,” I said.

“I’m sure there are. And you’re just the guy to tell me about them. What do we need to know?” Stacey asked.

I explained to Stacey that some homebuilders, typically larger companies that build many homes each year, cover the cost of building the home through builders’ mortgages. The homebuyer only needs a completion mortgage to purchase the property. Completion mortgages are the same as a typical mortgage used to buy a resale home with the mortgage money advanced on the day of possession in one lump sum.

Smaller homebuilders, or people who want to act as their own general contractor, usually need construction or draw mortgages. With a draw mortgage, the bank advances the mortgage funds in three or four stages at specific points of the construction process. The first draw of mortgage funds is typically made when the foundation has been completed. The next usually occurs when the house is at lockup, meaning the walls are enclosed, the roof is attached and the doors and windows have been installed. Some lenders will then either allow a draw at the drywall stage or require the homeowner to wait for a final draw at completion. The homeowner is expected to have the money to pay for construction costs up to the point of each draw.

“Let’s say it costs $40,000 to get the foundation dug and
poured. You have to pay for that out of your savings and the builder digs and pours the foundation. An appraiser goes out and confirms the foundation is complete and then money is released to you by the bank,” I said.

Andrew and Stacey didn’t have any liquid savings that they could use to pay for construction costs up to the point of each draw. They did have equity in the condo that they could access through a Home Equity Line of Credit (HELOC) but they decided they wanted to move sooner than the six to 12 months it would take to build a home from scratch.

A few weeks later, Andrew called me to say a young doctor had made an offer to buy their condo. The woman had asked for only a few days to get her financing in place and complete due diligence on the condo corporation. She wanted to take possession of the condo at the end of the month. That was only two weeks away.

“We’ve reached a deal that’s within $2000 of what we were hoping for so we’re really happy with the offer. We need to find a place quickly,” Andrew said. He explained that he and Stacey had been looking at a number of spec homes that builders had completed.

“We’ve got it narrowed down to two homes. We’re going to have another look at both, and we’ll probably write an offer on one of them this evening.”

I reminded Andrew that even though he and Stacey had a pre-approval in place, it was extremely important to include a subject to financing clause in their purchase offer.
“You and Stacey are strong clients but a pre-approval isn’t a guarantee of financing. Even when we get the commitment letter from the bank there will be conditions outlined in it that we’ll have to satisfy,” I said.

In addition to proving their income, Stacey and Andrew would have to prove their down payment was coming from the sale of the condo. They’d need to provide a copy of that purchase contract and the waiver showing that the sale was “firm” and the doctor had removed her conditions for financing, property inspection and reviewing the condo documents.

“You don’t want to be left in the lurch if the person buying your condo changes her mind and backs out of the deal,” I said. “If you made an unconditional offer you’d be putting yourself at risk. You’d have to scramble to find a new buyer who wanted to close in two weeks. Or you’d have to quickly refinance the condo, pull equity out for your down payment and turn it into a rental while you waited to find a buyer.”

Andrew promised to put the financing condition in the purchase contract and to let me know when the contract was accepted. The next morning, Stacey called to say they had reached a deal with a builder on a brand new 1800-square-foot house. It was a two-storey with three bedrooms, a great ensuite bathroom and beautiful hardwood floors and granite countertops. The price was $419,000 including net GST.

“I love the walk-in bedroom closet. It’s huge!” Stacey gushed. “I’ll finally have enough room for my clothes. Andrew loves the double garage and figures finishing the basement will be a project
he can handle on his own.”

“Congratulations!” I said. The three of us should meet and talk about a couple of strategies you should consider with the mortgage.”

That afternoon Stacey and Andrew were so excited that they practically skipped into my office. They had the purchase contract, their job letters and pay stubs, their current mortgage statement and the contract for the condo sale. They knew what they were buying, and they knew the size of the mortgage they needed and the interest rates that were available. It was time to get serious about developing smart strategies that would help them manage the mortgage over the long run.

“I know it’s exciting to be moving into a brand new home. The downside is you’re increasing your debt load by nearly $150,000,” I reminded them. “You need to consider how that extra debt is going to impact your financial picture over the short, medium and long-term.”

I asked them to consider several important questions:

- Were they planning on having children and if so when would they have them?
- Would Stacey stay home with the children for a number of years?
- Were there any career changes they could foresee?
- When did they want to be mortgage free?
- When did they want to retire?

“Wow, we’ve talked about having kids and travelling before we got too old but we never considered any of it in the context of
having a mortgage,” Stacey said. “I never really thought about the impact a mortgage could have on those things.”

Most people don’t consider the long-term implications that their mortgage has on their lives. Most will spend more time surfing consumer review sites to make a $400 television purchase or plan a $4000 vacation than they will on a $400,000 house purchase. This is not a criticism. It’s a function of human nature and our society. It’s difficult to predict and plan over a timeline of 20 or 30 years.

Mortgages are complicated, cryptically worded and intangible products. Lenders are in business to lend money, not educate people on the long-term ramifications of borrowing money. Sadly, the education system doesn’t teach people financial literacy and most people only know what their parents have told them based on past experience. The result is that the vast majority of people focus on the interest rate and the monthly payment since these are the two areas bankers and mortgage brokers always talk about and advertise.

Stacey and Andrew wanted to start a family in the next two or three years and Stacey would go on maternity leave for a year before deciding if she would go back to work. Since their new mortgage was going to be conventionally financed (mortgage default insurance wasn’t required) they could have a 30-year amortization. While they would pay more in interest over the long term if they weren’t careful, the lower required payments would take the pressure off their household cash flow when Stacey was on maternity leave.
If they took the longer amortization it would be wise to aggressively pay the mortgage balance down while they were at a higher income level and before child expenses started to appear.

“Let me tell you from first hand experience, diapers and day care are really, really expensive,” I said. “At the peak, our daycare expenses were $500 more than our mortgage payments.”

Andrew blanched and Stacey looked worried.

Depending on the lender, homeowners are allowed to increase their regular mortgage payments by 10 to 25 percent. A few lenders allow clients to double their regular payments. In addition to payment increases, most lenders allow homeowners to make lump sum payments. Some lenders allow lump sum payments at any time while others have restrictions such as once per year on the anniversary date.

“Let’s say you get a tax refund because you contributed to your RRSP. You could take that refund and use it to pay down your mortgage,” I said. “You’d get a ‘guaranteed return on investment’ because you are saving the interest cost on that money.”

Stacey and Andrew were getting a new, larger mortgage at an unusually low interest rate. They needed to consider the possibility of that larger mortgage renewing into a normal rate environment closer to five or six per cent. How would they handle higher payments? A two per cent rate increase would add hundreds of dollars to their payments overnight.

“Let’s say at renewal your mortgage payment increases by $350 per month. That’s $4200 per year in after tax dollars,” I said. “Payment shock can really hurt.”
Andrew felt his income would increase modestly over the next five years with further promotions but agreed his income might not increase enough over five years to match the extra cost.

Andrew and Stacey decided they would start with a 30-year amortization as they were sure they’d have a baby in the next two or three years. They decided it was important to be with a lender that offered generous pre-payment options.

They would increase their payments every year and every time they received a raise. The gradual increase in payments and the resulting lower outstanding balance would make it easier to adjust to a higher rate and payments.

“Ok, now that we’ve figured out a smart mortgage plan for the two of you, let’s discuss interest rates,” I said.

I explained to my friends that there were two lenders offering special, slightly lower interest rates for clients who could close their new mortgage in the next 30 days.

Mortgage money is like any other product that is sold. Some lenders are willing to lend their money ‘on sale’ if it means they can get it placed as new mortgages quickly. Both lenders had the same special rate but one had better pre-payment privileges. The choice was obvious.

“We should hear back from the lender in the next day or two. Have a great evening,” I told the excited couple as I walked them to the door.

The next afternoon I received an approval for Andrew and Stacey. The lender outlined the conditions that needed to
be satisfied prior to committing to fund their mortgage. These included an appraisal of the new house to confirm its fair market value, and whether the builder had completed all of the work. I ordered the appraisal and called Andrew to let him know the news about their approval.

“That’s great news!” he said. “I have good news too. The woman buying our condo has waived her conditions. The place is officially sold.”

Andrew and I set up a meeting for that evening so he and Stacey could review the terms of the mortgage and sign the commitment letter. We reviewed the interest rate, the amortization and the pre-payment options for the mortgage. I picked up a copy of the waiver for the condo sale, confirmed the name of the lawyer they were going to use and explained that I expected to receive the appraisal report in the morning.

The following day the appraisal report arrived by email. The appraised value was just higher than their purchase price and the property was 100 per cent complete. I sent the appraisal, the signed commitment letter and the remaining required documentation to the lender for review, and let Stacey and Andrew know that it would take about 24 hours for the lender to sign off on the documents.

The next afternoon I received confirmation from the lender that all the conditions had been satisfied. I immediately called Andrew.

“Congratulations! Everything is in order and you and Stacey can now remove your financing condition on the new house.”
“Awesome! Thanks for your help,” he said. “Stacey is going to be thrilled.”

It’s always rewarding to help clients reach an important goal. I decided to leave the office a little early and hit the bike trails for some exercise. The fresh air would help me to think; I had a few challenging files that might not have such happy endings.
CHAPTER 3
Too Much Debt
ONE SUNDAY AFTERNOON IN LATE JANUARY, Catherine and I brought our sons to the local sledding hill for some fresh air and fun. A two-week cold snap had finally broken and it was a perfect chance to get the boys out of the house to burn off some of their frenetic energy. We had been sledding for about ten minutes when we were joined by a family from our neighborhood.

Chris and Julie are a typical, Canadian middle-class couple. They’re in their late thirties and are busy shuttling their three children between school and activities like hockey, swimming and tae kwon do. They are established in their careers, own a nice home and two newer cars, and try to have a winter vacation every couple of years. In short, their household budget is as stretched as their schedules.

We watched the kids careen down the hill, hitting a jump midway and wiping out in a flurry of snow, tangled limbs and laughter.

“Remember what it was like to be seven years old and not have a care in the world?” I chuckled.

“Yeah,” Chris answered wistfully. “Actually, Julie and I would like to meet with you to see if you can help us. The Christmas credit card bills have arrived and it seems like a good time to look at our finances and see if there’s anything we can do to save some money.”

“Sure. I can come over any evening next week after the kids are asleep.”

“Wednesday would work.” Julie said. “Our kids don’t have anything that night so we can get them to bed a little earlier.”
On Wednesday evening I walked the three blocks to Chris and Julie’s house. Chris answered the door.

“Hi! Come on in,” he said. “I’m just finishing cleaning the kitchen.”

He loaded the last of the dinner plates into the dishwasher while Julie and I talked about the challenges and triumphs of careers and parenthood.

“So, how long have you lived here?” I asked.

Julie explained that they had bought their two-storey house from a builder about ten years ago, shortly after they were married. They had made some progress on paying down the mortgage the first couple of years before they had children. Once the children arrived and she was on maternity leave, they gave up on making extra payments on the mortgage.

“It’s like we were in survival mode and just trying to hang on for a couple of years,” she said, as Chris joined us at the kitchen island. “That’s when we started slowly sliding backwards into debt and we just haven’t been able to turn things around yet.”

“The boys each play hockey three times a week, plus there are other lessons on weekends and homework every night,” said Chris. “We’re just barely hanging on most of the time.”

Julie transitioned from part-time to full time work when the youngest of their boys entered Grade One. But with car payments, children in after-school care, expensive activities like hockey and snowboarding lessons, and other endless costs of raising a family, there was never quite enough money.

The monthly shortfalls slowly but steadily led to a $15,000
balance on their personal line of credit. Then disaster hit when Julie was unexpectedly laid off. It took the better part of a year for Julie to find a new job and during that time the debts piled higher, resulting in another $12,000 spread over two credit cards.

“I’m working again but now we’re so far behind I don’t know how we’re going to get rid of the debt,” she admitted. “The minimum payments are $450 per month on the line of credit and $360 per month on the credit cards,” she explained. “It’s taking a huge bite out of our budget.”

“Depending on your mortgage balance and the value of the house, you could refinance and roll most if not all of the debt into a new mortgage,” I said. “There are going to be a couple of hurdles you’ll have to clear before we can do that though.”

The federal government, through its ability to legislate mortgage default insurance rules, has made it increasingly difficult for Canadians to refinance their homes to pay off high interest debt.

Originally, Canadian homeowners were allowed to refinance to 95 per cent of the value of their homes. Then the government, via its control of CMHC and influence on other mortgage default insurers, instituted a series of mortgage rule changes. Over the course of four years, they reduced the maximum loan to value on a refinance to 90 per cent, then 85 per cent and finally, in July 2012, to 80 per cent of a property’s value.

The political argument given each time was that, with interest rates in the low single digits, Canadians were taking on too much debt. People needed to remember that debt had to be
repaid, and when interest rates eventually returned to normal levels, their payments could skyrocket. If homeowners couldn’t afford the higher payments, it could trigger a wave of mortgage foreclosures.

Another argument was that tougher rules would stop Canadians – especially habitual refinance clients – from using their homes as ATM machines.

While it’s true there was a small minority of homeowners who refinanced their home every few years to pay off spiraling credit card debt and lines of credit, most people were more disciplined.

“My personal belief is that it’s far too easy to get unsecured credit in Canada and that if the government truly wanted to protect Canadians from the perils of debt, it would force banks to reign in credit card offers, unsecured lines of credit and car loans,” I said.

“I’ve been called by banks several times in the last couple of years offering $10,000 or $15,000 credit cards and personal lines of credit without so much as a credit check or application,” I added. “It’s too easy to get that type of debt. And car loans are handed out like candy.”

“Don’t banks make more profit on credit cards, lines of credit and car loans because of the higher interest rates?” Julie asked. “I’m sure they wouldn’t want stricter rules.”

Canadian banks are powerful organizations and the government doesn’t have the same ability to directly control underwriting standards and policies with unsecured debt like
it does with mortgage debt through CMHC. Bankers know that restrictive refinancing rules also improve the retention of their mortgage clients. Approximately 90 per cent of homeowners renew their mortgage with their existing lender.

“I believe that 90 per cent loan to value was the right limit for refinances,” I said. “It left people with a small equity buffer in their home but gave flexibility to get rid of expensive, high interest debt and dramatically improve their monthly cash flow.

“My personal record was helping one family free up more than $4000 per month by rolling all their debt into a new mortgage. Needless to say, that really reduced the financial stress that family was under.”

“You saved them $4000 per month? That’s incredible!” Chris said.

“Yes, that’s like saving the annual, after-tax income on a well-paying job,” I agreed. “Many refinance clients will free up at least $500 per month, depending on the original mortgage rate and the amount of consumer debt being cleaned up. If we push back the amortization to 25 or 30 years it can be an even bigger monthly amount.”

“Having an extra $500 per month would be great,” Chris said.

“Yes, but remember that you’d still have the same amount of debt after the refinance and most, if not all, of that $500 per month should be used to pay the new mortgage down aggressively,” I replied.

Chris and Julie believed their house was worth about $400,000. They had originally borrowed $325,000 and now owed
$233,700 on their mortgage at a current rate of 4.5 per cent. Their remaining amortization was 16 years and their current monthly mortgage payments were $1761.35 per month.

Their unsecured debt totaled $27,000, not including a car loan of $18,000 that they borrowed at zero per cent financing during a promotion at the dealership.

“We won’t touch your car loan since it is at zero per cent. Even if it was at a higher rate than the mortgage, it likely isn’t a good idea to amortize a car loan over many years by rolling it into a new mortgage,” I said.

I explained that there were two paths they could take on their refinance, depending on how much time was left in their current term and what the payout penalty was on their existing mortgage. Chris and Julie could break their existing mortgage and pay their penalty. This would give them the opportunity to get the best rate available at their current lender or a new lender. If they went back to the same lender they might get a 10 to 20 per cent discount on the penalty, depending on the lender’s policy.

Penalties can vary dramatically, from a few hundred to tens of thousands of dollars depending on the type of mortgage and how the lender calculates the penalties. Variable rate mortgages typically have penalties of three months of interest. As an example, if the interest portion of the regular monthly mortgage payment was $1000, then the penalty would be $3000.

Fixed rate mortgage penalties, called Interest Rate Differential (IRD) penalties, can be very expensive and are more difficult to calculate. The penalty is calculated based on the mortgage
balance, the months remaining in the current term, the difference between the existing mortgage rate or the non-discounted rate at the time the mortgage was set up and the current rate for the term closest in length to the remaining time in the current mortgage.

Lenders don’t have universal parameters on the rates used to calculate the penalty but banks typically have more expensive IRD penalties than monoline lenders. They’re called monoline lenders because they only sell mortgages. They don’t offer other products like car loans and personal lines of credit.

If Chris and Julie didn’t want to break their current mortgage and pay a penalty, they might be able to ‘blend and extend’ their mortgage. In this scenario the new mortgage amount and the rate on that amount is blended with the existing mortgage amount and rate to give an averaged rate on the total amount borrowed.

Not all lenders will extend an existing mortgage term. They’ll simply blend the existing and new rates for the remaining amount of time on the current term.

“We need to find out what your payout penalty is, what a blended rate would be, and then crunch the numbers to determine the best course of action,” I said. “I’ll need you to call your lender to find out the penalty and the potential blended rate.”

I explained to Chris and Julie that if they chose to refinance, in addition to a payout penalty, they would need to pay for an appraisal on their home and legal fees on the new mortgage. The appraisal would likely cost between $250 and $350. Legal fees would be about $1000.

“I do have one lender that will pay the appraisal and legal fees
but I never promise that to clients because at this point in our conversation I don’t know enough about your finances to know if you’ll be approved by that lender,” I said. “I’ll certainly try to save you money on the legal and appraisal costs if I can.”

There was still one potential hurdle that had to be overcome. As people fall farther into debt, it becomes harder to juggle outstanding bills and continue making at least the minimum payments. Missed payments have a dramatic impact on credit scores. I gently broached the subject with Chris and Julie since many people are embarrassed to discuss bad credit situations.

They quickly glanced at each other and then Chris, looking at the floor, explained that they had been late a few times on making their credit card payments and a dental bill had gone to collection.

“I lost my benefits when I was laid off and we just couldn’t afford to pay a $900 bill for the boys’ check-up and cleaning,” Julie said. “We paid the bill when I started working again. I don’t know if it was reported on my credit history. Will this ruin our chance to refinance our mortgage?”

I explained that it was highly likely the collection was on Julie’s credit history and we would find out how bad the credit damage was when I reviewed their credit reports. If one of them had very bad credit, we could potentially remove that person from the mortgage application, provided the other person qualified for the mortgage based on their own income.

If both credit scores had been severely impacted then they might consider a private, second mortgage to consolidate the
deb into a single loan while they worked at improving their credit scores.

“What is a private, second mortgage?” Julie asked.

Second mortgages are usually offered by alternative lenders although occasionally a bank will place a mortgage behind its own first mortgage or one that is registered by another of the Big Five banks. The order in which a mortgage is registered on the property’s title determines whether it is a first, second or third mortgage.

The mortgage in first position on title has the strongest claim against the property. Mortgages registered in second and third positions run the risk of not being repaid if a property is sold for less than the value of the total amount of money borrowed against the property.

That higher risk of not being repaid by the borrower means that the interest rates on second mortgages are much more expensive than first mortgages. The higher rate might still be cheaper than the cost of carrying balances on credit cards.

Second mortgages are typically provided by companies or individuals willing to take on greater risk in return for higher returns. Canadians who have RRSP plans with specific financial institutions that offer self-directed RRSP accounts can loan their savings as private mortgages.

Private mortgages are usually used in situations where a person can’t qualify, or doesn’t want to qualify with a traditional institutional lender.

“Can you get people a private mortgage?” Chris asked.
Mortgage brokers often help clients get private mortgages. Private mortgage lenders put much less focus on the homeowner’s income and credit score and much more focus on the amount of equity in the property. Private lenders do not pay brokers a commission so brokers charge clients fees. The fees are usually paid out of the money borrowed.

Private mortgages can be very useful to pay out judgments and liens that have been registered on a property’s title. ‘A’ lenders won’t refinance to pay out tax arrears or court-imposed fines that are registered on a property’s title, so a private second mortgage is used to clean up the problem. Once the judgment disappears from the title, a new first mortgage is arranged, if possible, to replace the existing first and second mortgages.

It was getting late. I had Chris and Julie sign a consent form giving me permission to pull their credit history and asked them to let me know what the bank said about their payout penalty and their blend and extend options.

Chris called the following afternoon. The bank would give them a blended rate of 3.85 per cent for the next five years. This option would allow them to avoid a payout penalty. If they did break the existing mortgage their payout penalty was $3800.

“Okay, thanks for finding that out. Now I can crunch some numbers to see what your refinance situation will look like,” I said.

I then explained that while the dentist bill collection and the late payments had indeed shown up on Chris and Julie’s credit reports, the damage wasn’t as bad as they feared.
“The collection shows as paid and the two credit cards that you missed payments on have been paid on time for the past year,” I said. “The scores are in the 650 range so they’re fair.”

“Is that good enough for us to get approved?” Chris asked.

“I think there’s a very good chance I can get you a new mortgage at very good rates,” I said. “Lenders look at the overall strength of the deal and your situation is strong despite the credit bruises. You’ll have about 35 per cent equity in the home after the refinance. Your incomes are good and there have been no other credit problems in the past year. This shows the trouble you did have was due to Julie being laid off. Give me about 20 minutes and I’ll get back to you with how a refinance would look.”

When I calculated the numbers it was obvious that refinancing was a wise decision for Chris and Julie. If I rolled the unsecured debt, their payout penalty of $3800 and legal fees into the new mortgage, they’d borrow $265,500. This would mean their loan to value was 66.37 per cent.

With a one per cent rate reduction, plus the elimination of the high interest debt, Chris and Julie would have monthly payments of $1804.59, without changing their amortization. They were originally paying $2,571.35, including the mortgage and unsecured debt. The refinance would reduce their overall payments by $766.76 per month or $9200 per year. They could take that money and make extra payments on the mortgage to reduce the balance. Over a number of years they could save significant amounts of interest and be mortgage-free sooner.

I called Chris back and walked him through the figures.
“Wow, that’s fantastic,” he said. “Let’s go ahead with that.”

“Okay, give me a day or two to get back to you with an approval,” I said, before hanging up the phone and writing the application notes that explained Chris and Julie’s situation to the underwriter.

The next afternoon, I received a commitment letter from Chris and Julie’s new lender that outlined the terms of the mortgage and the conditions that had to be met before the money could be funded.

Chris and Julie were employees so I needed to provide the lender with a job letter and pay stub for each of them. I also had to provide a copy of their current mortgage statement and a copy of the title for the property. I was able to order the title online from the land titles office.

Some lenders require full appraisal reports for refines, regardless of the loan-to-value, while others will determine value by running the property through a database of recent sales in the area.

With refinance transactions, especially in a stagnant or falling housing market, there’s a risk that the appraised value is lower than expected and the clients can’t proceed with the refinance because of the 80 per cent loan to value rule that was implemented in July 2012.

Fortunately, Chris and Julie’s home appraised well and there was enough equity for us to complete the refinance. Once the appraisal and other lender conditions were met, their new mortgage funded and they could breathe easier.
A few weeks later, I ran in to Chris in the automotive section at the hardware store and asked how things were going.

“Things are really good with the mortgage. You don’t realize the pressure you’re under until it’s suddenly gone,” Chris said. “We feel so much more relaxed just knowing that we’re saving money and we have a plan for paying down that debt.

“Now that our payments are lower, we’re splitting our extra money into three chunks. Three hundred dollars per month is being saved for the kids’ education plans. We’re investing another $200 for retirement and the rest is set aside in an emergency fund,” he said.

“That’s really smart,” I replied. “Once you have your emergency fund built up, you can start saving to make lump sum payments on the mortgage. With time and discipline, you’ll be able to really make progress with paying down your mortgage balance.”

“Yeah, it’s the discipline I’m worried about,” Chris said ruefully. “After looking at the thermometer this morning, I was very tempted to go online and book a trip to Mexico. But we know we have an opportunity right now to really get ahead financially and Mexico can wait another winter or two. When we do go, we’ll be able to really enjoy ourselves without being financially stressed.”

“I’ll raise a pina colado to that Amigo,” I said, before heading down the aisle to look for a new battery for my car.
CHAPTER 4
THE END OF A RELATIONSHIP
ONE MORNING IN LATE MARCH we awoke to a heavy snowstorm.

“Oh no! Is winter ever going to end?” Catherine groaned, as she looked out the front door.

“I think I’ll work from home today,” I announced, watching the large, wet flakes plunge to the ground in a steady stream, covering everything in a thick blanket of white. “I’m going out to clear some snow so people can make it down the sidewalk.”

I pulled on my parka and mitts and stomped down the front steps into shin-high snow. My neighbour, Connor, stumbled down his steps a few moments later and waved, shovel in hand. We started clearing a path to the street and after ten minutes of huffing and puffing, met in the middle of the sidewalk.

“Well, that’s my morning workout,” I said, leaning on the shovel and pushing back my toque.

“I’m glad I saw you this morning,” Connor said. “My sister and her husband are splitting up and need to figure out things with their house. They have kids and I think she wants to stay in the house to keep some sense of stability for them.”

“I’m really sorry to hear that,” I replied. “Is it amicable or messy?”

“It’s messy. Things had been rocky for a while and he finally moved out about four months ago. Well, got kicked out is more like it,” Connor said. “Can I put you in touch with my sister?”

“Yes, I’ll explain her options for keeping the house, assuming she wants to,” I said. “Many people prefer to sell the home so they can start over with a clean slate.”
“Her name is Rebecca. I’ll tell her to give you a call.”

The next afternoon Conner’s sister called and explained her situation.

Rebecca and Owen were in their early forties and had been married ten years. They had two children: a six-year-old boy named Tanner and a seven-year-old girl named Mackenzie. Owen was an airline pilot and Rebecca was an elementary school teacher who had moved from full time to substituting after her daughter was born.

In their first year of marriage, Owen applied for a better job at a different airline. They moved to a new province where they knew no one, and after a whirlwind weekend of home shopping, they purchased a new house in a subdivision that was a twenty minute drive from the airport.

The early years of their marriage were good but the difficulties of raising children without a family support network started to chip away at the foundation of their relationship. The stress was exacerbated by Owen’s work schedule and frequent overnight stays in other cities.

“I was always looking after the kids, trying to get them to school, to soccer and gymnastics and keep the house together,” Rebecca explained. “Things seemed so easy for Owen. He’d be home for a few days at a time but then gone again. If he came back from an overseas flight he’d sleep all day because of the jet lag, so he wasn’t able to help me out. I started to resent the job and him. But that wasn’t what finished us.”

She told me that one evening her cell phone rang. The call
display showed it was Owen but when she answered she could hear rustling and other sounds that had little to do with aircraft navigation.

“It turns out he had pocket dialed me while he and one of his co-workers were getting busy in a hotel room after a flight to LAX,” Rebecca said, her voice laced with anger.

I just nodded silently. Sometimes I deal with people who are experiencing really raw emotions and there’s nothing reasonable to say.

“The locks were changed and his clothes were on the front lawn when he got back,” she added. “It’s all such an awful cliché but there’s no way I could ever trust him again. For me, it’s one-strike-and-you’re-out when it comes to cheating.”

Rebecca said she had thought about selling the house and moving elsewhere but felt that keeping Tanner and Mackenzie in their school and home surroundings was best for their emotional stability.

Keeping the matrimonial home is often a difficult decision because the home holds bittersweet memories. For Rebecca and Owen, this was the house where their children were babies, and the neighbourhood where Tanner and Mackenzie started their first day of school. This was the house of Christmases and birthday parties and camping in the backyard. Rebecca started to cry as she told me about the surprise party that Owen threw to celebrate her fortieth birthday.

“My parents flew across the country to be there,” she said. “I came home from grocery shopping and there were fifty people in
my living room.”

I told Rebecca she faced the practical challenge of paying the mortgage and other household expenses on one income.

“Often in a buyout situation, the spouse who keeps the house ends up with a larger mortgage than the family originally had,” I said. “That can really add financial stress in what is already a stressful time.”

Owen was helping to pay the mortgage for now but wanted to either put the house on the market or have her take over the mortgage and buy out his equity.

I explained to Rebecca that in order for either her or Owen to get a mortgage there would have to be a legal separation or divorce agreement in place, especially since there were young children involved.

Lenders want to know if there are spousal and child support payments in any situation where a client is separated or divorced. The person receiving support can use the payments to help qualify for a mortgage. The person making the payments must be able to service the payments, just like a loan payment, when qualifying for a mortgage.

In situations where there isn’t a separation agreement, some lenders will occasionally make an exception and allow the client to swear a statutory declaration that says he or she isn’t required to make payments.

“Have you reached an agreement yet?” I asked.

“No, we’re working on it but nothing is finalized. We’re trying to keep things civilized and as long as Owen is fair and reasonable
I don’t see why we should pay a fortune for lawyers,” she said.

I asked Rebecca if she was working part-time or full-time. She told me she was picking up more hours and planned to apply for a full-time teaching position for the next school year.

“Any idea what your credit score might be?”

“It should be perfect. I pay all the household bills, and I’m never late,” she replied.

“Okay, but do you have credit? Do you have any loans or credit cards in your name?”

She had a $5000 credit card in her own name. All her other loans had been joint accounts with Owen.

“Thank goodness you have that credit card! Do not close that account,” I said.

One of the biggest dangers for women facing a separation or divorce is not having active credit of their own. If they don’t have a separate credit history it poses a significant problem for getting a mortgage. The client might need a co-signer – which can seem like a slap in the face – or she might have to go to an alternative lender that charges higher interest rates and fees.

I explained to Rebecca that the buyout process would depend on the final loan to value of the mortgage. If the mortgage amount was 80 per cent or less than the value of the home, the buyout would be treated as a refinance. If the loan to value was greater than 80 per cent, mortgage insurance rules dictated that the transaction be treated as a purchase, and a purchase contract between spouses was required. In either situation, an appraisal of the property would most likely be required.
Like a regular purchase, the new mortgage can be as much as 95 per cent of the lower of the purchase price or appraised value. Unlike a regular purchase, existing equity in the property can be used for the down payment.

“Thank goodness I can use equity for a down payment. I’ve drained my savings account to pay for my lawyer,” Rebecca said. “The only other money I have is in RRSPs and I don’t want to pay income tax by cashing out those investments.”

Rebecca realized that taking over the house and getting a new mortgage would be a process and there was work to do before she’d be ready to move forward.

“You’re first task is to get the separation agreement ironed out. You also need to get your job situation and income solidified so we know how much you’ll be able to qualify for,” I said.

Rebecca and I talked every couple of months so she could update me on her progress. She moved to full-time teaching in time for the new school year. The terms of the agreement with Owen were negotiated and the agreement was expected to be signed by both by early spring.

It was a bittersweet accomplishment for Rebecca to take over the house but now she and her children have a base of stability from which to move forward in the coming years.
CHAPTER 5
THE PITFALLS OF SELF-EMPLOYMENT
“HURRY UP BOYS! WE’RE GOING TO BE LATE!” I called upstairs.

My sons’ escalating laughter drifted down the stairs. “Get your shoes and jackets on and grab your backpacks! Let’s go!” I hollered. It was business as usual for our school day scramble.

We made it to the school just as the morning buzzer blared. “Make it a great day,” I said, tussling unruly hair as the boys headed inside.

One of the benefits of being self-employed is that I have the flexibility to walk Griffin and Zennen to school and avoid rush hour traffic during my morning commute to the office. It was a fine, autumn morning and I took my time strolling back to the house so our dog could pause to sniff and explore his surroundings. I watched a squirrel scramble up a tree as it built a cache of food for the winter. The leafy canopy of soaring elms had already turned to clay and gold, and a flock of Canada geese in V formation honked their way across the clear morning sky.

Back at my home office, I double-checked my list of new clients to see if there were opportunities to refer them to my networking group of business owners and sales people. Every Thursday, our group gathered for a lunch meeting designed to help generate business for other members and solve client needs by referring them to a trusted professional. I’ve attended this weekly networking meeting for several years now and have developed strong friendships with the members.

I checked the status of a couple of mortgage applications and then drove to the referral meeting. My friend Bryan was getting
out of his car as I pulled in to the restaurant parking lot. He spotted me and waited while I parked.

“You’re just the guy I want to talk to,” Bryan said as we headed to the meeting. “I think you might be able to help a friend of mine. His name is Paul. He has a wife and a little girl and he’s going through a rough patch right now.

“The company he worked for was bought by a competitor a couple of months ago and he was declared redundant,” Bryan explained. “He’s tired of working for someone else and wants to start a business. He’s thinking about refinancing his house to get some working capital. Would you mind giving him a call and seeing if you can help him?”

“I’ll give him a call this afternoon and see what I can do,” I replied. “I can’t make promises because he’s so recently self-employed.”

I phoned Paul after the meeting and introduced myself. We agreed to meet the next morning at his home.

Paul’s two-storey suburban house was in the city’s southwest quadrant. He and his wife Cindy, a part-time nurse, bought it from a builder about 15 years ago.

Paul answered the door with a welcoming smile. His four-year-old daughter, Isabelle, peeked out from behind his leg.

“Thanks for coming over to meet with me,” he said. “Cindy and I decided to pull Isabelle out of daycare to save money while we’re figuring out our next steps. That makes it a little harder to get out and about. Cindy’s at work right now. She’s picking up as many shifts as possible until I figure out what I want to be when
I grow up.”

Paul and I sat down at the kitchen table while Isabelle quietly drew in a scribbling book.

Paul explained that he worked as a middle manager at a local manufacturing company for 15 years but his position was eliminated after a new set of owners decided to centralize some of the logistical planning at their existing head office.

“They called me in to a meeting, explained I was being laid off, outlined my severance package and gave me 15 minutes to pack my desk,” Paul recalled. “A woman from HR and a security guard watched as I packed my things in a couple of boxes and then they frog-marched me out of the building. It wasn’t the best day of my life

“I was in a shock for a couple of weeks,” he continued. “I didn’t know what to do. My job was my identity and it felt like it had been stolen. But now I think this may be the start of a new adventure.”

The experience had left such a bad taste in Paul’s mouth that he didn’t want to work for anyone else again. He wasn’t sure if he should buy a franchise, start from scratch as a real estate agent or become a consultant who focused on streamlining supply management chains. Whatever the business, Paul wanted to borrow some of their home’s equity to help launch his new career.

I ran some quick calculations on the estimated value of their property and their current outstanding mortgage balance. There was about $150,000 in equity the couple could access if they refinanced their home.
The immediate challenge was whether they’d be able to qualify for a larger mortgage now that the family income had dropped.

“Since you are considering striking out on your own, I’ll give you a crash course on some of the ins and outs of mortgages for self-employed people,” I said.

I explained that in the eyes of a banker the world is divided into two major groups of people. The first group consists of employees. Bankers love to lend money to them, provided they have good credit, because employees have predictable incomes and it is easy to determine how much money they can afford to borrow.

“It’s a black or white situation when you are an employee,” I said. “You either make enough to support the mortgage payments, property taxes, utilities and other debts, or you don’t.”

The second group of borrowers is comprised of entrepreneurial business owners and commissioned sales people who eat what they kill.

Self-employed people are risk-takers who are prepared to gamble their time, energy and potentially their life savings on an idea. They’ll fund a start up with credit cards and sometimes literally ‘bet the farm’ in the volatile world of business.

These people are high risk in a banker’s eyes and often with good reason. They might not draw an income at all in the early years of the business or their income can be extremely unpredictable. Most new businesses fail within the first year or two and a huge number of the initial survivors fail in the
following five years due to owner burnout from daily frustration, stress and fatigue.

Canadian mortgage lending practices are fairly conservative since lenders want to make sure borrowers can make the mortgage payments as promised. Bankers do not want to foreclose on properties. Foreclosure is a long, expensive and messy process. There’s no joy in forcing families out of their homes and there is always the possibility that the proceeds of a distress sale won’t cover the mortgage balance and associated legal, maintenance and real estate costs that lenders incur in the process.

Consequently, self-employed people come under closer scrutiny.


I explained that while self-employed Canadians often face significant hurdles, there are a number of avenues for getting a mortgage. The best option depends on a person’s specific situation and priorities.

“Let’s start with looking at the different types of lenders and the degrees of expense, at least in terms of interest rates,” I said. “Obviously there are the big banks. There are also monoline lenders – called monoline because they only sell mortgages. Monoline lenders usually get client referrals from mortgage brokers.”

Both lender types provide highly competitive rates to people who are deemed to be lower risk. These ‘A’ clients can typically prove their income and have reasonable to excellent credit scores.
I explained that self-employed clients who have been in business for at least two years can qualify for mortgages from these lenders in one of two ways – either proving their income or stating their income.

A self-employed person can prove her income by showing her two most recent Notices of Assessments (NOAs). These are the forms Canada Revenue Agency sends a few weeks after an income tax return is filed.

The taxable income stated on Line 150 of the NOA is used to determine the qualifying income.

Most lenders will use the average of the two years of income provided the income for the most recent year is higher. Lenders recognize that business owners write off many expenses such as vehicle and home office expenses to reduce their income tax burden. Consequently, most but not all lenders allow the income on line 150 to be grossed up by 15 per cent.

“Let’s say you’ve shown a taxable income of $50,000 for the last two years. I’d be able to gross that up to $57,500 for your qualifying income,” I said.

‘A’ lenders may ask for additional income documentation like company financials and personal T1 Generals to get a sense of the overall health of the business.

Lenders also want to see a current NOA because it proves the business owner’s income taxes are paid up to date. Canada Revenue Agency can file a judgment against a property for outstanding taxes. This is extremely worrisome for lenders because the tax department gets paid before lenders in the event
of a forced sale. That increases the possibility of a lender suffering a loss in a foreclosure.

A business owner who can prove two years of income can buy a home with a five per cent down payment and will pay the same mortgage default premiums that employees pay. The premium for only having five per cent down is 3.15 per cent of the mortgage amount or $3150 per $100,000.

“That seems pretty straightforward,” Paul said.

“Just wait,” I said. “Things are about to get a bit more complicated.”

Some self-employed clients show little or very modest personal incomes despite having successful businesses. They often choose to be tax efficient and leave money in their business rather than drawing it as personal income.

These clients can still deal with ‘A’ lenders but must state their income since the declared personal income on their tax returns isn’t enough to qualify for the mortgage.

CMHC cancelled its stated income program in 2014, leaving Genworth and Canada Guaranty – the two other mortgage insurance providers – to insure these higher risk loans.

My personal belief is that CMHC cancelled its stated income program because the federal government is trying to generate more tax revenue from small business owners.

In order to state income with an ‘A’ lender, a person must have excellent credit, no recent late payments and must have a down payment of at least 10 per cent.

Gifts from relatives are allowed on insured stated income
mortgages as long as at least five per cent of the down payment is from the borrower’s own resources.

The person will have to prove he has been self-employed by way of a business license or company articles of incorporation. He’ll also have to prove or swear that he doesn’t have any income taxes owing.

Many ‘A’ lenders will charge a slightly higher interest rate on stated income mortgages.

The mortgage default insurance premiums for stated income deals are expensive. A client with 10 per cent down will pay a premium of 4.75 per cent. Someone proving income with 10 per cent down would pay 2.4 per cent.

“Wow! That’s almost double!” Paul said with a low whistle.

“The risk profile is significantly higher if the lender doesn’t have any way to confirm the person’s income,” I explained. “It’s like speeders and accident-prone drivers who pay more for car insurance because they are more likely to have a claim.”

The insurance premiums can add up to a significant amount at 90 per cent loan to value. A $350,000 mortgage would incur $16,625 in insurance premiums.

“We’ll come back to those premiums in a bit,” I said.

Most lenders require the homeowner to get mortgage default insurance for any stated income mortgage that is more than 65 per cent of the value of the home.

On conventional or uninsured mortgage applications some ‘A’ lenders will require the client to have a strong net worth or savings of six or 12 months worth of mortgage payments.
“So how do your clients decide what income to use? Do they just pick a number?” Paul asked.

“Yes and no,” I said, pausing to take a sip of freshly brewed coffee that Paul had poured. “The amount stated has to be reasonable given the type of industry a person is in. Let me give you the classic example. Imagine a hairdresser is buying a house and she’s stating an income of $100,000. If the hairdresser rents a chair at the local salon and is two years into her career then it’s highly unlikely she has built enough of a client base generating that amount of income. On the other hand, someone who owns a full service salon with ten hairdressers renting chairs and paying a cut of their sales to the salon, might earn $100,000 or more. Lenders and insurers look very carefully at higher stated incomes and those deals are difficult to get approved.”

“I’m considering getting into real estate. What sort of income is reasonable for real estate agents to state on an application?” Paul asked.

“Sorry, no dice unless you are only borrowing 65 per cent of the home value. If you’re borrowing more, then you can’t state your income with an ‘A’ lender,” I replied. “Real estate agents earn commissions and are issued T4s with a known gross income, just like employees, although they have business expenses that are deducted from their gross incomes.

Some ‘A’ lenders will allow real estate agents and other commissioned sales people to state their incomes if the mortgage amount is 65 per cent or less of the home value.

The qualifying challenges and high insurance premiums that
go with stating income with an ‘A’ lender have created a fantastic business opportunity for ‘B’ lenders.

These are second-tier banks and trust companies that provide mortgages for self-employed people who can’t prove their income. They also cater to clients with proven income but sloppy or poor credit history. Some borrowers might even owe income tax or have outstanding collections.

These companies will allow clients with good credit to state their income with as little as 15 or 20 per cent down payments.

Clients won’t be charged mortgage default insurance premiums although most lenders will charge a fee of one or two per cent and interest rates and loan amounts can range depending on various risk factors like credit history and property type and usage.

“But why wouldn’t that person state their income with an ‘A’ lender and still get a better rate?” he asked.

I explained there could be a number of reasons including minor credit issues or lack of self-employment history that would prevent someone from stating their income with an ‘A’ lender.

Self-employed borrowers must prove they’ve been in business for at least two years if they want to borrow from an ‘A’ lender while most ‘B’ lenders only require six months of self-employment history.

‘B’ lenders will ask for three to six months of bank statements to show the business deposits are in line with the income amount the borrower is stating.

“These lenders are prepared to take a bigger risk on the client
but because of this, they look very closely at the property,” I said. “They don’t want to get stuck with properties they can’t sell.”

To reduce the risk selling the property for a loss in a foreclosure, ‘B’ lenders scale back the amount they’ll lend on apartment condominiums, town houses and older properties.

They won’t lend on mobile homes and they may charge larger fees or scale back how much they’ll lend as a percentage of value on extremely expensive properties that would be difficult to sell quickly if the mortgage went into foreclosure.

‘B’ lenders prefer to lend on properties in major cities. The loan to value may be reduced if the property is in a bedroom community and these lenders won’t lend in small towns or rural areas.

Many business owners think that because they have great credit and a strong net worth they should get the best mortgage rate available. But a really savvy business owner might happily pay a higher mortgage rate on a ‘B’ lender’s mortgage because they are saving a tremendous amount of money.

“What? I don’t follow the logic,” Paul interrupted.

“At the end of the day, what matters is not your mortgage rate,” I said. “It’s how much money you’ve spent, right?”

A business owner who claimed personal income of $100,000 per year in Alberta would pay about $26,000 in income tax. They’d pay $52,000 in taxes over two years in order to qualify for the best rate at an ‘A’ lender. They would pay $20,194.47 in interest over two years on a $350,000 mortgage at 3.0 per cent at a 25-year amortization.
If the person structured his finances so he showed a personal income of $45,000, he would pay about $7,950 per year in taxes or $15,900 over two years.

The same $350,000 balance amortized over 25 years but at 3.69 per cent rate and a one per cent fee would cost $24,850.66 in interest and $3500 for a fee for a total of $28,350.66.

The person with the great rate from the ‘A’ lender would pay a total of $72,194.47 in income tax and interest on their mortgage. The person borrowing from the ‘B’ lender would pay a total of $44,250.66 over two years. The $26,943.81 difference would help them grow their business.

“The best rate isn’t always the best solution,” I beamed.

Paul was silent for a few seconds. “Poof! That was the sound of you blowing my mind,” he deadpanned.

“So there are ‘A’ and ‘B’ lenders. Just out of curiosity, are there ‘C’ lenders and clients?” Paul asked.

“Of course! But there aren’t ‘D’ lenders unless maybe you’re borrowing money from your parents or the mob,” I said.

A ‘C’ lender is a private lender. This is a company or private individual who lends money based largely on the amount of equity in the property. Private mortgages are sometimes called “hard money” loans although that is an American term.

The rates for private mortgages are significantly higher than institutional rates and clients usually pay lender and broker fees in order to obtain the mortgage. The client’s income and credit worthiness are far less important to a private lender although they’ll often want to know some of those details. It’s possible, but
highly discouraged, to get a private mortgage without having any income.

Most people will never deal with private lenders although there are times when someone with excellent credit and income might use a private lender. An example of this is if a person wanted to buy a house, renovate it and flip it for a quick profit. Banks aren't interested in lending on flip projects because they can be high risk and banks don't want to end up trying to sell a half-renovated home if the mortgage goes into foreclosure.

Private mortgages are expensive and they should only ever be considered as short-term solutions. It's important to have a solid plan for repaying the mortgage figured out before ever applying for the mortgage.

“This is all really good information but it sounds like we won't be able to do a refinance unless we get a private mortgage,” Paul said.

“Not necessarily,” I replied.

I explained that we could try to refinance the house with an ‘A’ lender using Cindy’s part time income, if her hours were guaranteed. If they weren’t guaranteed then an average of her past two years of income would be used for qualifying. If she didn’t qualify because she didn’t fit a bank’s debt servicing ratios, a ‘B’ lender might allow her to borrow money because they have more latitude for their debt-service ratios.

If she still didn’t qualify, Paul would have to start his business using savings, unsecured debt and cash flow from Cindy’s job. After six months of being self-employed, he’d have a better idea
of his business income and we could potentially refinance the home with a ‘B’ lender.

“Thank you for your time. You’ve given us a lot to think about,” Paul said. “I’m going to have a chat with Cindy and explain things to her. I guess the first thing I should do is decide if I want to buy a franchise or go into real estate.”

I started to put on my jacket and headed for the door. Isabelle came running over and handed me a lined piece of paper scribbled with purple, pink and yellow crayon.

“It sounds trite but you have plenty of options and in the meantime you can enjoy some quality time with Isabelle,” I said, putting her masterpiece into my briefcase. “One day they’re starting school and before you know it they’re asking for your car keys.”
CHAPTER 6
Mortgage Renewals
“RUN BOYS! GIVE IT ALL YOU HAVE!”

It was the first game of another soccer season and I was coaching a group of six and seven-year-old children who were one goal behind with only a few minutes left to play. One girl chipped the ball to my son, Griffin, who was clear in front of the net. The goalkeeper was out of position so it was a brilliant chance to tie the score. Griffin kicked the ball for all he was worth and it sailed into the net.

“Hurrah!” a nearby grandma shouted.

Time ran out and the game ended in 4-4 tie.

“Good game coach,” said Phil, the father of twin boys the same age as Griffin. We had spoken casually over the course of the summer and I knew that he and his wife, Veronica, also had an older daughter from her first marriage.

“Listen, when you have a moment,” he started, “I’d like to get your advice on my mortgage renewal. It’s coming up in a few months and I’d like to explore my options.”

“Sure. Let’s grab a seat at that free picnic table,” I suggested.

“A friend of mine told me she and her husband were able to move their mortgage to a new bank and get a far better rate than their bank offered them. Is that common?” he asked.

“Unfortunately, it’s not as common as it should be,” I answered.

Most people don’t realize they can move their mortgage – usually without cost – to a new lender when their original term is expiring. Lenders call this a switch or transfer.

“Imagine you’re a professional athlete. You’re approaching
the end of your contract with your existing team. You can sign with your team or you can become a free agent and switch to a team offering a better deal, ” I said.

“The same concepts apply at mortgage renewal except that it’s about who will charge you less money, not who will pay you more.”

Banks count on homeowners to take the path of least resistance when their mortgage is up for renewal. After all, what could be easier than signing a piece of paper and mailing or faxing it back to the bank?

Never simply accept a bank’s renewal offer at face value!

Complacency is a costly condition that pads the bank’s bottom line at the homeowner’s expense. According to recent information released by CMHC, almost 90 per cent of Canadian mortgage holders renew their mortgage with their existing lender. That customer loyalty can be costly, as lenders routinely don’t offer existing clients the same rates as new clients.

The lender will usually send a renewal letter by mail. The letter will outline a variety of terms and rates and the bank hopes the borrower will take the options at face value, make a choice, sign the form and send it back with no questions asked.

Lenders typically make renewal offers between one and six months prior to renewal. If the homeowner doesn’t send the renewal form back, she’ll probably receive a telephone call from an employee with the bank’s retention team.

The bank employee, often located in a call centre, will try to get the homeowner to commit to a new term, usually by offering
a rate that can only be held for a few days. If the borrower has done any research at all, they’ll know the offer is uncompetitive; if they object then the retention team member may immediately offer a lower rate. The lower rate may still be more expensive than what is available at other lenders.

Phil’s face registered surprise as he took in this information. “That’s interesting!” he said. “I guess it’s not realistic to expect the bank to leave money on the table without a fight.”

“Lenders are in business to maximize profits for their shareholders,” I said. “They’re definitely not charities.”

Homeowners are usually well-served by speaking with a mortgage broker to get a sense of current rates and the direction those rates might take in the future. I told him that the mortgage industry is unique in that most lenders and brokers view each other as ‘partners’ when they are providing a mortgage for a new client. But many lenders view that same broker as a competitor when the mortgage comes up for renewal. Banks want to keep their existing clients since the second term of a mortgage is more profitable than the first term. That’s because the bank pays more for underwriting, broker compensation and other acquisition costs incurred to initially obtain the client’s mortgage.

“As you can imagine, they really want to keep the client if they can but they also don’t want to give away the farm,” I said.

We stopped for a minute to check on the boys who were still entertaining themselves in the playground.

“What is involved in moving our mortgage to a new lender?” Phil asked.
“It’s pretty straight forward and it shouldn’t cost you anything, provided you’re not changing the amount of money you are borrowing,” I said.

If homeowners are increasing the amount of money they are borrowing, for example to pay for renovations or to pay off unsecured debts, then it’s considered to be a refinance and all the refinance rules apply.

Switches can only happen at maturity or when a mortgage is open. If a homeowner tried to move a closed mortgage they would be required to pay a pre-payment penalty because they didn’t honour the full term of the mortgage. This would then be treated as a refinance.

I explained that on a renewal application, clients must qualify based on their current income and credit like any other mortgage application. One difference is that the loan to value on a renewal can be greater than 80 per cent.

“That’s good news because we’ve only been in our house for five years and we only made the minimal down payment,” Phil said. “We owe about $405,000 and I figure our place is worth about $470,000.”

“So you’re at about 85 per cent loan to value. That’s fine,” I replied.

A second difference is that a lawyer is not needed to complete the transaction on a renewal so homeowners don’t have to pay legal costs. Third party companies will handle the legal paperwork and the new lender will cover the cost.

Lenders often charge a fee to discharge a mortgage. Some
lenders will pay this fee on behalf of the homeowner. From the new lender’s perspective, the discharge fee and the reduced legal costs are a small price to pay in order to get a new mortgage on the books.

“Beyond comparing rates, a mortgage renewal is an excellent point to review your financial and life goals,” I told him. “Chances are there have been significant changes and surprises in the years since the mortgage was first put in place.”

A family’s income has probably increased in the years since the mortgage was first set up so a renewal is a good time to increase payments and reduce the amortization, especially if current interest rates are lower than the original rate. What may have been a suitable mortgage strategy back then may not be the best course of action now.

“We were just happy to qualify for a mortgage when we bought our home,” Phil said. “As far as I remember, the bank person we spoke with didn’t talk about any specific strategy. They just said, ‘You should take the five-year-fixed rate’ so we did.

“Our first term was at 5.5 per cent so we should be able to get a significantly lower rate now,” Phil said. “That will make a big difference.”

“Absolutely,” I said. “If you kept your payments the same, a lower rate would shave years off the time it takes you to pay off the mortgage.”

A homeowner might consider scaling back the mortgage payment and using the extra cash flow to pay off more expensive debt like credit cards, unsecured lines of credit and car loans.
“No, we’re good on that front,” Phil said. “We pay our credit cards off every month and we’re driving 10-year-old vehicles that we bought used and paid cash for. We’re definitely not keeping up with the Jones,” he laughed.

“Good job, Phil,” I said. “I wish more people were financially disciplined and lived within their means.”

There are a number of lenders who register some or all of their clients’ mortgages as collateral mortgages. This is very common with Home Equity Lines of Credit and mortgage and line of credit combination products. A collateral mortgage is usually registered for 100 per cent or more of the value of the property even though the loaned amount is 80 per cent or less of the value of the home.

Some banks register all of their customers’ mortgages as collateral mortgages and the amount registered on title is the same or greater than the value of the property.

“That doesn’t make sense,” said Phil, shaking his head.

“Banks tell clients they do this so the client can save on legal costs when they want to refinance and access more equity in their homes,” I told him. “That sounds like a good idea until clients discover they lose the flexibility to switch lenders easily at renewal or to get private second mortgages.

“In my opinion, collateral mortgage registrations are all about lenders maintaining and improving client retention rates and boosting long-term profitability,” I explained. “They are generally not in the homeowner’s best interest.”

“So if most people are renewing with their current lender,
what difference does it make if they have a collateral mortgage?” Phil asked.

I explained that clients with collateral mortgages must go to a lawyer and incur full legal costs if they switch lenders at renewal because the collateral mortgage must be discharged. The existing lender knows this and can therefore offer less competitive rates to the client at renewal because they know the client doesn’t want to pay legal fees. Fortunately, there are a couple of lenders who will absorb the legal cost in order to help a client with a collateral charge mortgage switch to a new lender.

Dusk was approaching and since it was a school night I needed to get my boys home and into bed.

“Once you get your renewal offer, give me a call and I’ll be happy to help you through the process,” I said to Phil.

“Or you can call your lender sooner and see what they have to offer. If they’re not being competitive we can do an application with a different lender so you have a rate held for you. Just like any other mortgage application, the rate can be held for 90 or 120 days, depending on the lender.”

“That sounds like a good plan. Thanks for your time,” he said.

A couple of weeks later Phil called me to tell me he had received his renewal notice. He had called the bank as I had instructed and he was able to get the rate lowered by .10 per cent.

“That’s a start. But they’re still not really in the game,” I said. “You could try grinding them some more or we can look at moving you to a different lender.”

Phil said he and Veronica were willing to spend the small
amount of time and effort it would take to do an application and gather the required proof of income.

“If you can save us $1000 or more that would be a pretty good return for an hour or two of work,” he said.

“I can get you a mortgage rate that is .15 per cent lower than your renewal offer,” I said. “On your current balance of $405,000, that works out to a saving of $31.93 per month. Over five years you’ll save $1915.80.”

“Seriously? That’s a lot of money,” Phil replied.

“Okay, but you need to know that once your bank finds out you’re moving on, they may offer you the same rate. They will play games by being slow to get the new lender a pay out statement with the existing balance,” I said. “Are you prepared to put up with the games and stick with me even if they match the rate?”

“Of course. Why should they get my business if they force me to hold their feet to the fire to get a reasonable rate?” he said.

We completed the application in about 15 minutes. I told Phil I’d need job letters and pay stubs for him and Veronica, as well as a current mortgage statement, the property tax statement and a void cheque.

“I’ll have to pull your credit reports so I’ll send you a permission form that I need you to sign, date and send back to me,” I said.

Phil was able to email me copies of the paperwork the next day and I submitted the application to the new lender.

In addition to the lower interest rate, the new lender had better
pre-payment privileges so Phil and Veronica could increase the amount of their regular payments or make lump sum payments to reduce the mortgage balance even faster.

I received a commitment letter later that afternoon and called Phil with the good news.

“Wow, that was fast,” he said.

“Your application was very straightforward and you are excellent clients from a risk point of view,” I replied. “It was a very easy decision for the underwriter to make.”

“When and where would you like to meet to review and sign the paperwork?” I asked.

“Can we do this over the phone and by email? It’s been extremely busy at home and at work. I don’t think I’ve seen Veronica for more than 10 minutes this week,” he said.

I said I’d be happy explain the mortgage terms by phone and walk them through the areas that needed to be signed. We set up a phone call for lunch the following day.

Phil and Veronica’s payments were currently $2500 per month at 5.5 per cent and a 30-year amortization. If they kept a 30-year amortization, their payments would drop to $1780 at the new rate. During our phone call I explained the benefits of keeping their payments the same. With the lower interest rate, more of each payment would go to paying down the balance and they would reduce the number of years it would take to pay off the mortgage.

“How many years are we going to knock off because of the lower rate?” Veronica asked.
I told her that if they kept the payments the same their amortization would drop to less than 18 years.

“Perfect! This is really exiting. Where do we sign?” she asked.

I walked the happy couple through the paperwork and confirmed that they understood the terms and the objective of the mortgage strategy, and then had them scan and email the commitment letter back to me.

A few weeks later at the end of another soccer game, I spotted Phil and Veronica sitting on the sidelines. I walked over to say hello and let them know their new mortgage had funded earlier in the afternoon without difficulty from their original lender.

“Congratulations! You’re well on your way to mortgage freedom,” I said.

“That’s a huge win for our family. Thanks coach,” Veronica said.

“Now we need a win for our team!” Phil said with a laugh.
CHAPTER 7
PRIVATE MORTGAGES
ONE GLORIOUS FRIDAY IN EARLY JULY, I decided to work from home so I could enjoy the weather and finish off my monthly client newsletter. By mid-afternoon the temperature approached 25 Celsius and I was thankful for the shade of the front porch as I worked on my laptop.

My cell phone started vibrating, an indication that a new email had arrived. The noise startled our dog, Bongo, who was dozing at my feet. He gave me an irritated glance before returning to his siesta.

The email was from a person named Fabian who had found my website and wanted to know if it was possible to get a loan to pay outstanding income tax. He asked that I call as soon as possible.

“Uh-oh. This could be a challenging situation,” I thought as I punched the phone’s keys.

“Smooth As Glass Drywalling. This is Fabian,” said a man whose voice was still young but clearly stressed.

I introduced myself to Fabian and explained that I was responding to his email for help.

“Wow, thanks for calling back so quickly,” Fabian said. “I’m really in trouble. I hope you can help me.”

“I’ll try my best. Tell me everything from the beginning,” I said, pulling out a notebook and pen.

Fabian explained that he owned a small drywall company that worked primarily with residential builders. Business was good for a number of years and he had built up enough money to buy a modest family home in an older part of town. As time went
by, any extra money that wasn’t reinvested in his business went to paying down the mortgage.

Unfortunately, the economy slumped into recession, work dried up and he started hemorrhaging money. Fabian laid off half his employees to try to preserve his business’ modest cash reserves. Still, his savings soon eroded to zero.

Then disaster struck when he got a letter from Canada Revenue Agency that said he was to be audited for three years of tax returns. The audit resulted in a tax bill of $57,000, including penalties and interest.

Fabian tried to get a personal line of credit from his bank but was declined because his credit score had dropped. He had maxed out his credit cards to cover operating expenses and he couldn’t refinance his existing mortgage because of his poor credit.

Months passed without Fabian clearing the tax bill. The CRA threatened to file a tax lien on Fabian’s home. The longer it took Fabian to solve his tax problem, the more he’d pay in penalties and interest costs.

“There may be a way to help you despite your credit score,” I said. “I might be able to get you a private mortgage but it’s really going to depend on how much equity you have in your home.”

“My neighbour’s home is for sale and he’s asking $350,000. My mortgage is about $148,000,” Fabian said.

“Well, that sounds promising. We’ll have to get an appraisal done which will give an accurate value based on recent sales of similar properties.”
“Okay, I’ll ask my neighbour to put me in contact with his real estate agent,” Fabian responded.

“Sorry Fabian. A real estate agent’s market evaluation isn’t the same as an appraisal,” I said. “Appraisers are specially trained to determine property values. Each lender has a list of approved appraisers but we can get a ball-park figure from your property tax assessment to get started,” I explained.

Fabian said his house was assessed at $333,000.

I did some quick math, punching the figures into my calculator.

“Great, that puts you at almost 45 per cent loan to value before we add the tax bill and your credit cards,” I said. “How much do you owe on your credit cards?”

Fabian said he owed about $23,000 spread across three cards.

“Were you late on any payments?” I asked.

Fabian said he had always made his minimum payment and whenever possible, had put a few extra dollars on one of the cards but he never managed to make significant progress on reducing the balance.

I quickly determined his total debt was about 68 per cent of the value of the house. This gave Fabian two options. He could get a new first mortgage with a ‘B’ lender that didn’t have reservations about clients who wanted to refinance to pay off tax bills. Alternatively, he could get a private second mortgage. The best option depended on his current mortgage.

“Fabian, tell me about the mortgage you have right now,” I said.
Fabian explained that he was four years into a five-year fixed rate mortgage at 3.49 per cent.

“It doesn't make sense to pay out that mortgage right now and get a new first mortgage because, first of all, you'd have a payout penalty and secondly, you'd be going from a low rate to a higher rate. A private, second mortgage is your best option,” I said.

“What's a private mortgage? What do you mean by second mortgage?” Fabian asked.

I explained to Fabian that private mortgages are loans provided by companies or individuals who are prepared to lend based on the amount of equity a homeowner has in a property.

Private mortgages are meant to be short-term solutions – usually one year or less – because interest rates are much higher than normal mortgages.

It's important to both the borrower and the lender that there is a clear exit strategy in advance of taking a private mortgage loan. The interest rates are typically far too high to carry indefinitely and lenders don't want to go through the hassle of foreclosing, nor do they want to end up owning the property.

The interest rates and lender fees for private mortgages vary depending on a number of factors, including the overall risk for the lender as determined by the mortgage priority, the loan to value, and the type and location of the property.

The priority of the mortgage as it's registered on the property’s title has a direct impact on the cost of a private mortgage. A first mortgage is the first mortgage to be listed on a property’s title.
When a property is sold, the first mortgage is repaid before any other loans registered on title. This provides the lender with a good degree of protection if the homeowner defaults on the mortgage payments and the property goes into foreclosure.

Private first mortgages will typically range in price from 4.5 per cent to 10 per cent. Lender fees will vary greatly but will usually range between one per cent and five per cent of the loan amount.

A second mortgage is one that is registered in second position on title, behind the first mortgage. From a lender’s perspective, this is a riskier loan. In the event of a foreclosure and forced sale, it’s possible there won’t be enough money realized to pay the second mortgage balance after any outstanding property taxes, real estate and legal fees, and first mortgage are paid.

Second mortgage interest rates are typically between 12 per cent and 18 per cent and lender fees will most likely start at two per cent.

Private lenders do not pay commissions to mortgage brokers so brokers charge clients a fee to arrange private mortgages. Fees will start at one per cent of the loan amount and can be significantly higher.

Private lenders often require borrowers to use a lawyer of the lender’s choice. The homeowner is free to get their own lawyer, however, this results in a second set of legal fees, driving up the cost of borrowing the money.

“I have a number of lenders who are likely to lend you money at 12 per cent,” I said.
“Twelve per cent! That’s outrageous. It doesn’t sound like it’s even worth doing,” Fabian protested.

“I’d suggest it’s worth getting the taxman off your back. Plus credit cards usually charge more than 12 per cent interest,” I said. “This is going to be a short-term mortgage and the first part of a two-step process.”

“Fine. How much is this actually going to cost?” he asked.

Fabian needed to borrow $90,000 to pay off his taxes and credit cards.

The lender fee would likely be four per cent or $3600; my broker fee would be two per cent or $1800 and legal fees might be $1500. Plus he’d need an appraisal which would run about $250.

“You could pay those costs up front or you could borrow extra and roll those costs into the mortgage total,” I explained. “If you borrow $100,000 it will cover all the fees and you’ll end up with enough to pay off your taxes, which are still accumulating penalties and interest. You’ll also have enough to pay off your credit cards.”

At 12 per cent interest, Fabian would make interest-only payments of $1000 per month. He was currently paying $690 in minimum payments on his credit cards.

“I can handle payments of $1000 per month,” Fabian said. “Are you sure you can get me the mortgage? How long is it going to take to get the money?”

Qualifying for a private mortgage is typically easier and faster than qualifying for a mortgage with an ‘A’ lender. Private lenders want to know if a loan makes sense and that they have a
reasonable chance of being repaid. They require a full application and usually ask for a copy of a borrower’s credit history but they are less stringent on income documentation and are willing to give much more leeway on credit issues and debt servicing ratios, within reason.

For private lenders, the quality, location and type of property, and the amount of equity the homeowner has in the property is critical. There must be enough equity to protect the lender’s loan if something goes wrong.

Private lenders will insist an appraisal of the property is completed so they have a level of comfort about the property’s value and condition. Private lenders will typically lend up to 75 per cent of a property’s value although it is possible that the loan will be for more or less, depending on the overall risk appetite for the lender and the circumstances around the property and borrower.

I felt almost any equity lender would be interested to loan Fabian money because his situation was relatively low risk. The loan amount wouldn’t exceed 75 per cent of the value of Fabian’s property. The property was located in a major city, and while the house was a little older, Fabian believed an appraiser would recognize the house was in great condition since he had done many renovations.

I explained that it would take a few days to get an appraisal ordered and perhaps a week for the lender and the lawyer to get the paperwork ready.

“I hate over-promising and then under-delivering so let’s say
it will take a couple of weeks before you have the money.”

“Great. You said this was step one. What’s step two?” Fabian asked.

“Step two is your exit strategy. Yours should be very achievable,” I replied. “Your credit score will be lower right now because you’re maxed out on your three credit cards. But once those are paid off, because you haven’t missed any payments, your credit score will quickly improve.”

A good credit score was important because my plan was to refinance the second mortgage into a new first mortgage when Fabian’s current mortgage was up for renewal. I’d start the process four months before Fabian’s renewal date so his interest rate would be guaranteed.

“In just over a year all of your debt will be at the best rates available. How does that sound?”

“That sounds okay,” Fabian said. “Are you sure you can’t get me a cheaper mortgage?”

“Let’s do an application. I’ll talk to some lenders and I’ll do what I can to save you some money. But I’m not going to make any promises. Private lenders charge what they charge because of the risks they face and because they know people need their money.”

Fabian and I completed the application over the phone. I emailed him a consent form so I could pull his credit and a disclosure document that I’d charge him a fee.

“Send signed copies of those back to me tonight or tomorrow. In the meantime, I’ll call a few private lenders to try to find you
the best pricing I can.”

I spent the rest of the afternoon speaking with lenders. They were all interested in Fabian’s deal but I found the best pricing with one lender that had several pools of investor money and was prepared to be aggressive in pricing.

“The story makes sense. The exit plan is realistic, and the property and client sound solid,” said Janice, who was my lender contact.

“We have to charge 12 per cent on the rate but we really need to get our money out into the market. I can shave a bit off the lender fee to get this deal. How does two per cent instead of our usual four per cent sound?” Janice said.

“Sounds like we have a deal,” I replied.

“Great. Send me his credit report and the application. Get me an appraisal from an appraiser on our list and I’ll send you a commitment letter. If everything looks good with his credit and the appraisal, then we’ll fund as quickly as the lawyer can get everything in place,” Janice said. “We’re going to use our preferred lawyer. He’s welcome to use the same lawyer to speed things up and save on cost.”

After hanging up with Janice, I phoned Irene, an appraiser who was on Janice’s approved appraiser list. I left a voice mail saying I’d email her the details and requested the job be done as soon as possible.

Two days later, the appraisal for Fabian’s house showed up in an email from Irene. I reviewed it to make sure the market value would support the loan. The value was slightly more than
Fabian estimated which meant the second lender had a bit more protection that originally thought.

I forwarded the appraisal and Fabian’s application and credit report to Janice who returned a commitment letter to me later that afternoon.

“Good news, Fabian,” I said when he answered the phone. “I have a mortgage for you and the lender’s fee is a bit less expensive than I originally quoted you.”

“How much cheaper?” Fabian asked.

“Two per cent or $2000 less,” I said.

“That’s great!” Fabian said, sounding relieved. “Listen, I’m with a customer and can’t really talk right now, but thank you so much.”

“No problem. I’ll email you the paperwork. Call me when you have a moment and I’ll go over the details with you,” I said.

Later that evening Fabian and I reviewed the paperwork over the phone. He sent me the signed documents back by email and I forwarded them on to Janice.

Within a week, Fabian phoned to say he had been to the lawyer and his taxes and credit cards were to be paid off the next day.

“I feel so much better. It’s like a weight has been lifted off my back,” he confided. “But I have to say, I still hate the idea of paying such a high interest rate and all those fees.”

“I understand. But it’s only for a year and you’ll be in a better place as soon as we refinance. The economy is picking up again and so will your business,” I assured him.
“You’re right. I’ll give you a call in eight months.”

“Great. I’ll add you to my newsletter mailing list so you don’t forget about me,” I said.

“Don’t worry, Jason. I won’t ever forget you. But you can send me your newsletter.”

Just then Bongo barked and stared at me impatiently, waiting for the delivery of his nightly dog biscuit.

“C’mon Bongo,” I said. “Let’s go to the kitchen. We both deserve a treat.”
CHAPTER 8
MORTGAGE FREEDOM
ONE MORNING I WAS WORKING through a stack of active and recently closed mortgage files that required updating or compliance review. Some of the complex files were more than an inch thick so when the phone rang, I was grateful for the interruption.

The caller introduced herself as Liz and said that Bill, a mutual friend, recommended that she call me to get some mortgage advice.

“That’s terrific. I’ll be sure to thank him for the referral and vote of confidence,” I said. “How may I help you?”

Liz explained that she and her husband, Mike, were in their mid-50s and were about seven to 10 years from retirement. Their children were finished college and had moved out of the family home a couple of years ago. Liz and Mike lived in a modest split level that still had a mortgage of about $96,000 owing.

“Now that the kids have finished school, we’re finally at the point where we don’t have that many major bills,” Liz began.

“Our daughter is getting married next summer and we will help out with some of the wedding costs, but after the wedding, there won’t be any other major expenses.”

Liz told me that that she and Mike were carrying about $10,000 in credit card debt but they could never clear the balance. Mike had a pension through work but Liz, who had worked off and on while raising the children, only had a small RRSP.

“We really want our house to be paid off before we retire,” she concluded.

“Your goal is achievable but I’d like to meet with you and
Mike at the same time to discuss the best course of action,” I said.

We agreed to meet the following afternoon at my office and I outlined the paperwork that I needed them to bring.

Mike and Liz arrived promptly, armed with their current mortgage and property tax statements and pay stubs.

“Thank you for coming in today. Would you like a coffee or tea?” I asked, as I ushered them into the boardroom.

“Nothing for me, thanks,” Liz said.

“I’ll have a coffee. Just black,” Mike replied. He was a big man with a broad chest and large hands that bore the scars of hard labour. Dressed in work clothes and steel-toe boots, he seemed a little uncomfortable in the plush chair at the boardroom table. He accepted the coffee and listened intently as I recapped the conversation Liz and I had the previous day.

“Mike, what’s important to you regarding your mortgage and finances?” I asked.

“I’m a carpenter,” he said bluntly. “I’m not getting any younger and I don’t know how much longer I’ll be able to work. I can’t imagine retiring and still having a mortgage.”

“Believe it or not, that’s becoming much more common,” I replied.

According to a Bank of Montreal survey released in spring 2012, almost half of Canadians between 50 and 59 who own a home still have a mortgage balance. More than 25 per cent of Canadian homeowners aged 60 to 69 are still carrying a mortgage. Many more are carrying other types of debt.

“That’s not going to be us. If I’m going to be a Walmart greeter
it’s because I want to stay active and have a bit of fun, not because I need to make money,” Mike said.

While Mike and Liz were clearly focused on becoming mortgage and debt free as they approached retirement, some Canadian retirees are carrying mortgages for strategic reasons.

With mortgage rates at record lows it can make more sense to invest that money to generate a higher return.

My personal view is this is a dangerous strategy for the majority of older Canadians. It’s true that today’s seniors are working longer and easing into retirement with part time jobs, contracts and consulting work. But most people probably can’t consistently generate after-tax investment returns that exceed the mortgage rate on their house.

That’s not to say no one should borrow against property to invest and generate income in retirement. A conservatively leveraged rental property portfolio can clearly make sense for people who are looking for monthly cash flow to augment their income.

Liz and Mike’s mortgage was coming up for renewal in a few months. This was fortunate because it meant they had a wide range of options, including renewing with their existing lender or moving to another lender that might provide the best option for their circumstances. If they switched lenders, the start of the new mortgage could be timed to match the maturity of the existing mortgage. That would allow them to avoid costly pre-payment penalties.

I suggested they roll the $10,000 credit card into the new
mortgage so their starting balance on the new mortgage would be $106,000.

“It makes me sick to carry a credit card balance and be charged outrageous interest rates like that but there’s always something that comes up and we can’t pay it down,” Mike said.

About 35 per cent of Canadians don’t pay their credit card in full each month and the average outstanding balance is just under $3500. That works out to $665 per year in interest charges on a 19 per cent card which will take 20 years to pay off if only the minimum payment is made.

The disadvantage of adding the credit card balance to the mortgage would be that the transaction would be considered a refinance rather than a transfer, and would require a lawyer to be involved.

Liz and Mike would recover the legal bill within three or four months because of the lower interest costs that would result from paying off the credit card. If they chose to, they could add the legal bill into the mortgage as well, bringing the mortgage to $107,000.

Paying out the credit card would free up $300 per month including $158 of interest, based on the 19 per cent rate on the card.

Once the new mortgage was funded, they could apply the $300 per month savings to the mortgage in the form of extra payments. Or they could split the $300 between the mortgage, an emergency fund and RRSP contributions.

“The guys at work are always complaining about how they
never make money in their RRSPs. Their RRSPs have only grown by the amount of money they add each month. We’ll put the money on the mortgage,” Mike said.

“Can you tell us about how we can make the extra payments?” Liz asked.

Most mortgages come with pre-payment privileges that allow a homeowner to increase their payments and make lump sum payments. The payment increase ranges between 10 and 25 per cent of the original mortgage payment, depending on the lender. Annual lump sum payments range from 10 to 25 per cent of the original mortgage amount. Depending on the lender, lump sum payments can be made on any regular payment date or on the anniversary date of the mortgage. A few lenders will allow homeowners to increase their payments and then double the payment.

Liz and Mike were currently paying $1118 per month. If they added $300 per month to their mortgage payments they wouldn’t change their monthly household cash flow and the extra money would pay the mortgage balance down faster.

I explained there were a couple of options Liz and Mike should consider. They could choose to reduce their amortization as much as possible at the start of the new mortgage term. Alternatively, they could start with a 30-year amortization but then use pre-payment privileges to reduce the effective amortization.

“Why would we want to start at 30 years? We want to get this mortgage paid off as quickly as possible,” Mike said gruffly.

“I understand your goal. But you may want to give yourself a
bit of insurance,” I said. “If we start your amortization at 10 years, your minimum payments are higher. You might have difficulty making those payments if you got sick, injured or laid off.”

If they started with a longer amortization but aggressively used the lender’s pre-payment options, they could reduce the effective amortization but still have a fall back position of moving to lower payments. I explained that no matter what starting amortization they chose, the mortgage could be set up so they would pay the balance off sooner.

I handed Liz and Mike a chart comparing two scenarios. Option One assumed they would start with the shortest amortization possible so that the payments worked out to approximately $1418 per month. Option Two assumed they would take the longest amortization but maximize their prepayment options using the full 15 per cent payment increases, doubled up payments and an annual lump sum so the total mortgage yearly payments equaled the annual payments in Option One.

“You can see that you are extremely close to being mortgage free in five years,” I said. “You just have to decide if you want to take the simple, aggressively short amortization in Option One, or take Option Two which is more complicated but gives you wiggle room if you ever run in to bad health or a lay off.”

Mike and Liz looked at each other and a big grin broke out on Mike’s face. Liz reached for Mike's hand.

“See honey, we can make this work,” she said. “We’ll be okay.”

Liz and Mike liked the simplicity of the first option and they were confident they could remain faithful to the plan.
“I know it keeps us with our nose to the grindstone but the economy is pretty good here and I think my body will hold up a few more years,” Mike said.

The application was submitted to a lender and a day later I received a commitment letter. The lender did a desk-top valuation of the property because the loan amount was likely to be less than 50 per cent of the house value. This saved the expense and time of getting an appraisal of the property ordered.

Two months later, on the renewal date of their existing mortgage, the new mortgage funded. I rang Liz at home to let her know the new mortgage was officially in place and their credit card was paid off.

“What a relief,” Liz said. “Mike will feel so much better. Thank you for your help.”

“It was my pleasure. I’ll touch base now and then to see how things are going.” I replied. I smiled as I hung up the phone. Mike and Liz now had more than a family wedding to look forward to. They had mortgage freedom in sight.
CHAPTER 9

Rental Properties
The snarl of a fence post auger chewing through dirt cut through the sweltering August air. Sweat made my glasses slide down my nose as I bent over to pick up another bag of cement. A neighbour helped my 72-year-old father carry over a post while his tenant heaved the auger out of the dark loam.

We were building a fence at my parents’ rental property, an investment that produces cash flow each month and supplements their retirement income. My mom and dad never had jobs with pensions. They had to save as much money as possible, build their own retirement fund and manage their investments wisely so they could live on more than just Canada Pension and Old Age Security.

When my parents bought their rental house a few years ago, it was the first time they had ever applied for a mortgage. The concept of good debt was foreign to my mom and dad who shortly after they were married paid cash for a modest home that they’ve lived in ever since.

“I just don’t like the idea of a large amount of debt hanging over my head,” my dad said.

Consequently, my parents made a down payment far larger than the 20 per cent required by lenders for rental properties. This reduced their debt exposure and improved the monthly cash flow of the property.

Bad debt is typically thought of as debt used to buy a depreciating asset like a vehicle or consumer items like televisions, vacations or clothes. Carrying a balance on a credit card is the worst kind of bad debt because of the high interest rates. Good

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debt is used to buy appreciating assets such as investment real estate. Alternatively, it can help you earn more money, such as taking on a student loan to get a better paying job. Mortgage debt used to buy rental properties provides an added advantage: the interest costs are tax deductible against the rental income earned.

Many investors try to spread their down payment money over as many properties as possible so they can have the maximum amount of property value under their control. For a brief time in the mid-2000s, it was possible to buy a rental property without having a down payment at all. This was extremely risky as the mortgage amount was most likely greater than the property value once mortgage insurance premiums were included.

Sometimes, personal or economic circumstances forced investors to sell. Any downturn in the housing market meant that they were selling for a loss before factoring in real estate agent commissions, mortgage pre-payment penalties and legal fees.

In our current lending environment, those lenders who allow rental property mortgages require a down payment of at least 20 per cent. Many lenders require mortgage default insurance on rental property mortgages between 65 and 80 per cent loan to value. For example, if a rental property is purchased for $200,000 then lenders would require a down payment of at least $40,000; some would require the buyer to purchase mortgage default insurance unless the down payment was $70,000.

For a couple of years, until October 2008, investors could obtain mortgages with 40-year amortizations. Maximum amortizations were later cut back to 35 and then 30 years for
rental properties. The longer amortizations made it easier for properties to cash flow. Some lenders also offered generous rental income credits which helped investors qualify for multiple mortgages.

Buying real estate on the speculation that prices will increase can be extremely dangerous. Many people over-extended themselves to buy additional properties, especially when prices were increasing dramatically, in the hope they could quickly sell the property for a profit. Lending guidelines around rental properties have become stricter and for good reason.

In Canada, the arrears rate which tracks how many mortgages are 90 days late on payment, usually sits between .25 and .35 of one per cent. But when bankers drill down and look closely at the properties that make up that one third of one per cent, a disproportional number are rental properties.

People in financial difficulty will do whatever it takes to keep their family home. Rental properties don’t have the same direct impact on a family’s well-being and so when squeezed financially, people are more likely to let the mortgage payments slide on the rental.

My dad called for another batch of mixed cement and when the last of the thick slurry disappeared into the posthole, we stopped for lunch and a cold drink.

“So Gordon, do you have any other rentals?” dad’s neighbour, Vern, asked between mouthfuls of pizza.

“No, I just have the one,” my dad replied.

“How about you, Jason?” Vern asked, offering me the box of
pepperoni and extra cheese. “Are you in the rental business?”

I told them that I first became interested in the idea of owning rental properties when my wife was pregnant with our oldest son. I was self-employed as a freelance photographer, primarily working for newspapers and magazines. I regularly photographed news events, professional sports games and music concerts. It was exciting work but the hours were terrible and the pay was worse. I realized that if I was going to properly provide for a family, I needed to supplement my irregular photography income.

Catherine and I attended a weekend seminar run by a company specializing in providing Canadian real estate investing education. We learned some of the basic concepts of real estate investing and I followed up on the seminar by devouring information from a multitude of books, seminars and websites that are available.

The key message of that initial seminar was to focus on properties that produced positive monthly cash flow: buy a property that could bring in enough income to cover all expenses, including the mortgage, property taxes and insurance, as well as a reserve income of $100 or $200 per month. Careful investors banked the surplus for tenant vacancies and repairs.

Once you bought your first cash flowing property and learned how to manage tenants and perhaps a property manager, you’d repeat the process to buy additional properties. The slow but steady wealth creation would come from the gradual reduction of the mortgage balance and the increase in the property price,
which usually tracks inflation.

Many Canadians buy investment properties to diversify their investments. There’s something about owning property that is more satisfying than mutual funds or bonds – especially when stock market gyrations seem to regularly decimate mutual fund and stock portfolios.

“Real estate investing ultimately opened the door for me to become a mortgage broker,” I added.

“How about you, Vern?” my dad asked.

Vern told us he had ten rental properties that he’d acquired over a 15-year period.

“I started with just one but then I ended up buying one every couple of years,” he said. “I didn’t have any particular goal when I started. I just thought it would be an interesting thing to do. Kind of like a hobby that might pay a return. But I found I enjoyed looking at properties and negotiating deals. I guess it became a little bit addictive and it sure helped that my wife and kids were supportive and helped me stay the course during the tough periods.”

Property management – or specifically tenant management can be the toughest part of real estate investing.

“I made every mistake in the book when I was starting out,” Vern admitted.

“Me too. It took a few bad tenants to learn how to really screen tenants properly,” I agreed ruefully. “I can tell you some stories, that’s for sure.”

Vern leaned back, filled his pipe with tobacco, and nodded in
agreement.

“Now that I’m retired, I putter around doing the maintenance work on the properties but I still leave it to my wife and daughter to handle the tenants. I’m too old to put up with the same old excuses about why the rent will be late.”

I asked if he had plans to buy more properties or whether he was content to maintain his current cash flow.

“Oh, I’m always looking and if the right deal comes along I’m ready to jump,” he said. “But I’m much more patient now. I guess a guy gets more careful as he gets older.”

“That’s right,” my dad injected. “You realize you don’t have the time to recover from mistakes like you do when you’re young.”

Over the years, Vern has paid down a significant amount on his mortgages. That allowed him to put secured lines of credit – commonly called Home Equity Lines of Credit (HELOCs) – on the properties.

If he sees a property that fits his investment requirements, he can borrow against his lines of credit and pay cash for the property. He can then do some minor cosmetic renovations like painting, changing the flooring and updating light fixtures, and then refinance based on the improved value. This allows him to pull out most of his initial money and he doesn’t have to worry about jumping through hoops to get a purchase plus improvements mortgage.

“I can then take my time getting a mortgage,” he says. “These days it seems like the banks want an arm and a leg before they’ll lend you any money. I’m not interested in scrambling to try to get
financing in place in order to close on a property. I do things at my own pace now.”

Not all lenders will provide a mortgage for rental properties and many lenders put a restriction on the number of properties or mortgages a client can have. Many lenders also charge a higher interest rate for rental properties because of the increased risk of the loan.

In cases where an investor has multiple properties, the lender looks closely at the existing portfolio to make sure it isn’t overleveraged and is producing enough cash flow after expenses to provide a buffer for the investor.

Investors are expected to disclose all of their properties and must be honest that the property they are buying is for rental, not personal use. Unsophisticated or unscrupulous investors will sometimes say they plan on living in the property so they can make a smaller down payment. This is mortgage fraud and any broker, banker or real estate agent who sanctions this should be dropped faster than a burning coal.

Many investors will use savings for their down payment. However, if they have enough equity in their primary residence, it’s common to use funds from a HELOC for the down payment. Payments on the HELOC are factored into the overall debt servicing calculations.

Investors who can prove their income will typically have their mortgage placed at a chartered bank or monoline lender just like any other AAA client with good credit.

Self-employed investors who can’t prove their income or who
are being tax efficient and don’t fall within regular debt servicing guidelines will have to get their rental property mortgages from alternative lenders. It’s common for the mortgage amount to be scaled back to 70 or 75 per cent of the value of the property and interest rates will be higher. Many alternative lenders will also charge a lender fee.

“I have a good pension and my properties perform well so I generally stick to the big five banks,” Vern said. “The only problem is half the time I end up dealing with a new banker and it seems like I have to tell them how to handle my application.”

One of the biggest dangers for new investors is wandering into their own bank to get a mortgage for their rental property. This is especially true if they are clients with great credit, income and net worth because it’s actually too easy for them to get a mortgage.

A banker, or broker for that matter, who isn’t familiar with clients who want to build real estate portfolios can really hinder the clients’ ability to qualify for more mortgages if the first mortgage or two are set up incorrectly. A banker or broker should be reviewing an investor’s real estate goals and timelines so that each mortgage is optimized for the overall portfolio. Much like chess, investors and their mortgage providers need to be thinking three or four moves ahead.

Investing in real estate shouldn’t be seen as a get-rich-quick scheme that doesn’t require work, effort or money. Buying the wrong types of properties, reckless speculating, or trying to grow too fast by borrowing too much, can result in financial ruin. Done
properly – and safely – it’s a slow, steady, predictable journey that builds long-term, intergenerational, family wealth.

“Well, come on, time to get back at it,” my dad announced, wiping pizza grease off his hands with a rag.

“No, that fence isn’t going to build itself,” Vern chuckled. “Jason, it sounds like you know your business. Next time I need a mortgage I’ll give you a call.”

“Hey, that would be great,” I said, scrambling to keep up with my father who had already headed to the fence post pile.
CHAPTER 10

REVERSE MORTGAGES
I HAD JUST TACKLED ANOTHER HEFTY FILE when the phone rang again. The caller was Hanna, a banker who refers me to clients who can’t qualify for a mortgage under the bank’s guidelines.

Banks will often refer clients to mortgage brokers because it’s far better to find a solution for the client than to leave the client feeling frustrated, rejected and disappointed.

“Hi Jason, I’ve got a challenge for you today,” Hanna teased.

“Ha! What else is new?” I laughed. “I always look forward to seeing what you politely refer to as your ‘technically-challenged’ deals.”

“These folks are so nice. She’s 73 and he is 76. They remind me of my grandparents,” Hanna said. “I really hope you can help them.”

Hanna explained that the clients, Ed and Helen, were a retired couple who owned their home but didn’t have any extra income beyond their Canada Pensions and Old Age Security. They were still relatively healthy and independent and didn’t want to sell their home. They needed money for house repairs, including a new roof and gutters, and they wanted to take a once-in-a-lifetime trip before they weren’t able to travel.

“I tried to get them a home equity line of credit but our debt service ratios for HELOCs are so strict that they just can’t qualify,” Hanna said.

“I’ll give them a call right now,” I said. “Thank you very much for the referral. They’re always really appreciated.”

I dialed Ed and Helen’s phone number and a smoky, deep
voice answered on the second ring.

“Good afternoon.”

I explained who I was and why I was calling.

“Ah, yes, the mortgage broker chap,” Ed said. “The lady at the bank told us she would have you call.”

I asked Ed to tell me what he and Helen wanted to accomplish with a loan. Ed explained that their house was almost 60 years old and needed some repairs that had probably been put off too long already.

“The place has great bones but the roof has pretty well had the bird,” he said. “And I'd like to get one of those new high-efficiency furnaces. The old one we have is a workhorse but it could pack it in tomorrow. Better to take care of it now than risk having it give up the ghost at 30 below.”

Ed and I agreed that it would be a good idea to meet in person. I offered to drive to their home the next morning.

Ed and Helen lived in a post-war suburb about 12 minutes from downtown. The house was an 1100 square foot bungalow with stucco siding, and sat on a huge lot.

I walked up the sidewalk and rang the doorbell. A shout came from inside.

“Just a moment. I'm coming!”

When the wooden front door opened, I was greeted by a man impeccably dressed in grey trousers, a tweed jacket and a bow tie. He carried his slight frame fully erect and sported a neatly trimmed white mustache.

“Good morning. I'm Ed. You must be Jason,” he said warmly,
extending his hand.

“Guilty as charged!” I replied. “How are you this morning?”

“At my age, every day I wake up is a good day,” Ed chuckled.

“Come on in.”

I followed him to the kitchen to meet Helen who was arranging homemade oatmeal cookies on a plate. An old, metal tea kettle with a black wooden handle was whistling on the stove and she stopped to fill the teapot with three tea bags and boiling water.

“We’ll have tea in the dining room,” she announced, handing Ed the teapot and me the plate of cookies.

The dining room was dominated by an antique table, and a side board and a china cabinet filled with figurines and china. There were a few family photographs, including one black and white picture of a young Helen standing in a garden in front of a weathered farmhouse.

“That’s Helen’s family home near Virden,” Ed explained. “When we married, I promised her that one day we would make the transatlantic crossing from New York to Southampton on the Queen Mary 2. But life got in the way and we just never seemed to have the money.”

Helen extracted three of her best china cups from the cabinet and began to pour the tea. She told me how she had moved to the city and met Ed one day at the bakery where she worked.

“Ed walked past our shop on his way to work every morning. We’d often catch each other’s eye and he’d look flustered and rush on by. One morning, he finally worked up the courage to come
in and buy some cinnamon buns,” she said. “He was so shy but he asked me to go for a soda after work. How could I hurt his feelings and say no?”

The steam from the tea had flushed her cheeks and she absent-mindedly pushed a stray lock of silver hair off her forehead. For a moment, I saw that beautiful young woman from the photograph.

“I was jumpier than a cat on a hot stove at the start of that date. I darn near spilled my chocolate milkshake on her dress.” Ed laughed. “Well, after I got over my nerves, I turned on the charm and the rest is history.”

Ed explained that he had moved to Canada from England a few months before he met Helen. He was looking for adventure and a change of scenery and had always heard stories about the prairies in letters from his aunt who had married a Canadian pilot during the Second World War. Ed and Helen married soon after meeting but never had children.

“If there’s one regret we have in life, it’s not having children,” Helen said. “I know they’re a lot of work when they’re little and you worry about them when they grow up and leave the nest. It would have been wonderful to have grandchildren now. I guess it just wasn’t meant to be.”

Ed spent the bulk of his career working for a manufacturing plant while Helen worked in a variety of shops. Three years before Ed was to retire, his company went bankrupt and the employees lost their pensions.

“I spent 25 of my best years at that plant. We had good jobs,
benefits and decent pensions. And then boom! One morning the front doors were locked and we were wiped out. All those years and I didn’t even end up with a gold watch,” he said, shaking his head.

Ed chewed quietly on a cookie for a few moments and gazed out the picture window.

“That sure threw a monkey wrench into our plans. I worked for a few more years, even a couple of years beyond 65 but there was no way I’d ever recover financially,” he said. “Now we get by on our Canada Pension and Old Age Security but we live like church mice.”

I asked Helen and Ed if they had considered selling their home and downsizing to a condominium or renting an apartment. They could then either live off of the proceeds or invest the money and boost their income from the return on investment.

Helen said she’d consider moving to a seniors’ home once they were no longer able to live independently but downsizing before then was out of the question.

“I put in a garden every spring. I grow tomatoes and zucchinis and carrots and peas,” she said proudly. “I’ve had a vegetable garden since I was a little girl. And I love my roses. I have six different varieties in the back yard.”

“No, sir. We won’t sell or move unless we get Old Timer’s Disease or some other terrible illness,” Ed added. “If it’s up to me, they’ll carry me out of here in a pine box.

“Besides, you should see my model airplane collection. The basement is chockablock with planes of all sorts. I have a
couple of large model train layouts too. There wouldn’t be room anywhere else for them and I’m not going to sell them or throw them in the garbage.”

Ed and Helen were clearly in a difficult position given the pension failure. They would have benefited by getting a secured home equity line of credit (HELOC) against their paid-off home prior to retiring. The HELOC would have provided them with easy and affordable access to equity in their home. Now that they weren’t working and were only living on government pensions, they couldn’t qualify for a HELOC because their income wasn’t high enough to support the debt servicing requirements.

I explained to the couple that they could still gain access to some of the equity in their home using a reverse mortgage.

“Personally, I’m not a fan of reverse mortgages,” I said. “I think most seniors are better off taking a line of credit instead of a reverse mortgage despite what the television ads show.”

Reverse mortgages are aimed at people who need to access equity in their home. The major selling feature of reverse mortgages is that applicants don’t qualify for the loan based on income and they don’t have to make any payments for as long as either spouse lives in the home.

This can be a real benefit for seniors who aren’t well enough to work and don’t have enough income to qualify for a traditional mortgage or line of credit. Seniors with meager incomes benefit from not making monthly payments.

The maximum amount of equity a homeowner can borrow is 50 per cent of the house value, depending on the person’s age.
and the location of the property. Loan-to-values are conservative because the lender doesn’t want the homeowners to be left with little or no equity when the property is eventually sold. If house prices increase over time, it helps the homeowner maintain and possibly gain equity.

While the interest compounds and is added to the original amount borrowed, the theory is that over time real estate prices will increase and help protect against the mortgage amount being more than the property value.

“There’s a not-so-very-funny line that reverse mortgages are perfect for people who don’t like their children and grandchildren,” I said to Ed and Helen.

The main Canadian provider of reverse mortgages says that if prices fall so dramatically that all the equity is lost, the borrower will never have to repay more than the value of the home.

“So we might lose the farm but we won’t owe more than the farm is worth?” Ed asked.

“It’s unlikely you’d lose all the equity as the lender intentionally loans a very conservative amount of the home’s worth. And you’re right, any loan amount more than the sale price of the home would be forgiven,” I said. “The underwriters are very conservative. They know that it’s bad for business if people end up with nothing.”

To qualify for a reverse mortgage homeowners must be 55 years old. If there is more than one owner, all the owners on title must be 55 or older.

The money borrowed is a tax-free source of income and
doesn’t impact a person’s Old-Age Security or Guaranteed Income Supplement benefits. The money can be accessed as a lump sum or through regular disbursements or a combination of the two.

The loan must be repaid when the homeowner sells the home or dies but it can also be repaid at any time before then. Early repayment may result in pre-payment penalties.

“You have two compelling reasons for considering a reverse mortgage,” I explained. “Your pension income isn’t enough for you to do what you want and you don’t have children or other relatives you want to leave an estate to. One potential draw back at the time of death is that it’s possible that it takes longer to settle the estate than the maximum amount of time the lender allows for the loan to be repaid.”

Reverse mortgage rates are higher than regular mortgage rates for a number of reasons, including that the money loaned is raised from investors via Guaranteed Investment Certificates (GICs).

My personal belief is that homeowners nearing retirement should consider obtaining a home equity line of credit (HELOC) on their home as an insurance policy in case they unexpectedly need money. They can access equity by simply writing a cheque, without worrying about qualifying or paying higher interest rates and lender fees.

Getting a HELOC before retirement also allows flexibility when seniors want to downsize. Instead of selling the family home and using that money to purchase a new dwelling, homeowners
can use the HELOC for funds. This allows them to stay in their original home and move at their leisure.

If the homeowner never borrows money against the line of credit, they won’t pay any interest.

“I wish we would have known about that option five or six years ago,” Helen said. “I don’t like paying more interest than we need to.”

“Well, what’s done is done,” Ed said.

“Listen, you certainly have a lot to think about and there’s no need to make a decision today,” I said. “I personally think reverse mortgages aren’t the best choice for most people but you may feel it’s the best option for you.”

As I drove home I thought about how seniors in similar situations will become more common as the population ages, savings rates fall and investments struggle to eke out single digit returns.

About a week later Ed called me to let me know that he and Helen wanted to go ahead with the reverse mortgage. I introduced them to the lender who processed their application and advised them they needed to get independent legal advice to make sure they understood everything involved.

A few months later, I checked my office mail and discovered a sleek postcard sent from Britain’s White Star Line luxury liner, the Queen Mary 2. The message on the back was in exquisite handwriting:
We're at sea and arrive in Southampton tomorrow, followed by a week in London. We'll think of you as we take high tea at the Ritz! This trip is all we had hoped for and better than we imagined. Just wanted to thank you for your help and advice.

All the best,

Helen and Ed

At the time of publication, reverse mortgages with a fixed rate range in price from 3.99 to 5.49 per cent, depending on the length of the term. A variable rate is prime plus 1.75 per cent. Reverse mortgages also incur additional charges including a lender fee, and appraisal and legal fees.
THE MORNING SUN STREAMED THROUGH our kitchen window. It was one of those beautiful, late winter mornings when the world seems clean, fresh and picture perfect after a light snowfall during the night. The days were slowly getting longer and spring no longer seemed like a remote possibility.

I flipped a batch of blueberry pancakes and checked to make sure the bacon sizzling in the frying pan was crisp but not burnt.

Griffin and Zennen were playing their favourite computer game in the living room. Catherine yawned and stretched as she came downstairs.

“Good morning, Sleepy Head,” I said, handing her a steaming cup of fresh coffee.

“Mmmm. Thank you,” she smiled after enjoying her first sip. She gave each of the boys a little hug before sitting down on the couch with a magazine.

I imagine that similar weekend morning scenes play out in hundreds of thousands of homes across Canada. The majority of those homes have mortgages on them. Ours certainly has one.

Most people probably won’t give their mortgage much thought on a weekend morning. That’s probably the way it should be. But while a mortgage seems like a mundane, unavoidable obligation that lingers for decades, it is an incredibly important piece of a family’s financial picture. How it’s set up and handled can make a world of difference over the years.

Most people’s lives follow fairly predictable patterns. We begin a career, find a mate and start a family. We buy starter homes and move up to larger homes as babies are born. As
the years go by, life throws us curve balls like layoffs, financial setbacks, illness and marital breakdowns.

We persevere through it all.

When the kids are grown and move out, we often decide to downsize during our retirement. If we’re lucky, we’ll be healthy enough to spend our golden years in our own home.

As life progresses, mortgage needs evolve. There isn’t a one-size solution that fits every one. What works for a 27-year-old single woman probably won’t be the best option for a divorced mother approaching retirement.

A mortgage should be strategically structured to meet a homeowner’s individual needs and goals. It should be reviewed regularly – preferably annually – to make sure it’s still the right vehicle to take you to your destination.

It definitely shouldn’t be ignored for years and then given five minutes consideration while on hold, waiting for the bank’s next available agent.

I have a happy, healthy family. I live in a beautiful home located in a great neighbourhood in an economically vibrant city that I really enjoy. My work is challenging, interesting and helps people realize their goals and dreams.

One day, Catherine and I will join the ranks of Canadians who own their homes outright. When we make our final mortgage payment, I’m sure the sense of financial security and achievement will be wonderful. I hope you achieve that goal too and that this book helps you along the way.
GLOSSARY

Adjustable Rate Mortgage – A mortgage that allows for the interest rate and payment to fluctuate. The fluctuations are based on changes in the prime rate

Amortized Mortgage – A mortgage that is repaid over time. Each payment is a combination of principal repayment and interest payment

Amortization Period – The length of time, usually in years, for a mortgage to be repaid

Appraiser – A licensed professional who determines a property’s value

Appraised Value – The value of a property as determined by an appraiser

Assessment – The value given to a property for taxation purposes

Bank of Canada – Canada’s central bank is tasked with setting monetary policy and does so by managing its key interest rate which influences banks’ prime rates

Blend and Extend – The process of borrowing additional money on an existing mortgage. This results in an averaged interest rate for the extended term of the mortgage

Blended Rate – An averaged interest rate

Bridge Financing – Short term financing needed to bridge the gap between the possession dates of two property sales
Canada Guaranty – One of Canada’s two private mortgage default insurance companies

Commitment Letter – A conditional mortgage approval that outlines a lender’s mortgage terms and the conditions that must be satisfied prior to funding

Co-signer – An additional mortgage applicant whose income or credit is needed to help the main applicant qualifying for a mortgage

Closed Mortgage – A mortgage that cannot be paid in full prior to the term’s maturity unless a pre-payment penalty is paid

Closing Costs – The extra costs associated with purchasing a property and funding a mortgage, such as legal fees, land transfer taxes and title insurance

Closing Day – The day of possession in a property purchase

CMHC – The Canadian Mortgage and Housing Corporation is a crown corporation that provides mortgage default insurance. It is the largest of the three insurers and accounts for about 70 per cent of the insured mortgage market

Collateral – The security a loan is registered against

Conventional Mortgage – A mortgage that is not insured when it funds. The loan to value is typically 80 per cent or less of the property value

Credit Bureau – A company that tracks and determines consumers credit scores
Credit Report – A report that shows a potential borrower’s credit score as well as the balances and history of payment of loans

Credit Score - A three-digit number that illustrates a person’s credit worthiness. Scores range from 300 to 900 with higher scores representing better credit

Credit Union – A member-owned, community-focused financial cooperative that provides financial services, including mortgages and other loans and investments

Debt Consolidation – The process of combining multiple debts into a new loan

Delinquency – A late payment on a loan or mortgage

Delinquency Rate – The percentage of loans with overdue payments

Default – A mortgage or loan that has not been paid as agreed

Down payment – The initial capital a potential homebuyer needs to purchase a property

Double Up – A prepayment privilege that allows for payments to be doubled

Economic Life – The expected period of time a home will be useful to the average owner

Equity – The difference between the value of a property and the mortgage balance. The equity is the amount of money that goes to the owner if the property is sold
Equity Loan – A private mortgage based mostly on the amount of equity a homeowner has in a property

Finder’s Fee – The commission a mortgage broker is paid for sourcing a new mortgage for a lender

First Mortgage – The first mortgage registered on a property’s title

Fixed Rate – An interest rate that is set for a specific term

Foreclosure – The legal process lenders take to recover the money owed when a mortgage goes into default

Genworth Canada – The larger of two private mortgage default insurance companies in Canada

Gift Letter – A letter that outlines that money given between immediate relatives for a down payment is a gift

Gross Monthly Income – The total, pre-tax, monthly income of a mortgage applicant

Gross Debt Service Ratio – The ratio determined by adding the Principal, Interest, Property Taxes, Heat and 50 per cent of the Condo Fees (if applicable) and dividing the sum by a borrower’s gross monthly income

Hard Inquiry – A term used to describe a credit pull initiated by a company to determine if credit should be granted. Hard inquiries impact credit scores

HELOC – A Home Equity Line of Credit is a line of credit secured by a property. Interest rates on HELOCS are lower than personal line of credits
High Ratio Mortgage – A mortgage that is insured by one of three mortgage default insurance companies

Hold Back – Money held back to ensure an obligation is completed

Insurance Premium – The premium paid by borrowers when a mortgage is high ratio, or insured

Interest – The cost of borrowing money

Interest Adjustment – An interest payment made to reconcile the time between the funding date of a mortgage and the date the first payment is due

Interest Adjustment Date – The date that an interest adjustment must be paid. It is often the day a mortgage funds

Interest Only Mortgage – A mortgage that does not require payments to include principal repayment

Interest Rate – The cost of borrowing money, expressed as a percentage of the loan

Income Property – A property owned with the intention of generating rental income from tenants

Job Letter – A letter required by lenders as part of the diligence process. It is written by an employer and outlines a borrower’s position and income and tenure

Lease – A contract between a landlord and a tenant

Liabilities – The debts held by a borrower
Loan to Value Ratio – The amount of money borrowed against a property’s value, expressed as a percentage

Lump Sum Payment – A one-time principal payment to a mortgage balance

Maturity Date – The last day of a mortgage term

Monoline Lender – A mortgage lender that offers only mortgages, rather than multiple lending products

Mortgage – A secured loan contract that is registered against the title of a property

Mortgagee – A mortgage lender

Mortgagor – A mortgage borrower

Mortgage Approval – An agreement by a lender to loan money at set terms upon satisfaction of specific conditions

Mortgage Balance – The amount of money owed on a loan

Mortgage Broker – A licensed individual who facilitates mortgage transactions between lenders and borrowers

Mortgage Brokerage – A company that employs and oversees mortgage brokers

Mortgage Default Insurance – Insurance that protects a lender from loss in the event a homeowner defaults on a mortgage
Mortgage Fraud – A criminal act of intentionally and materially misrepresenting or omitting details about a mortgage application or borrower in order to obtain a mortgage that would otherwise be declined

Mortgage Life Insurance – Life insurance that pays a mortgage balance upon death of the policy holder

Mortgage Payment – The regular payment required to service the cost of a mortgage loan

Mortgage Principal – The amount of money borrowed for a mortgage

Mortgage Renewal – The extension of a mortgage loan by a lender, possibly under new terms

Mortgage Term – The length of a mortgage agreement

Net Worth – The difference between a person’s assets and liabilities

Notice of Assessment – A Canada Revenue Agency statement sent to taxpayers after tax returns are filed. The Notice of Assessment outlines total income earned, allowable deductions, and indicates if a tax balance is outstanding or a refund is applicable

Open Mortgage – A mortgage that can be paid in full at any time without penalty

Owner Occupied Property – A home occupied as a residence by its owner
Rental Property – A home leased to tenants to generate income for the owner

PITH – Principal, Interest, Taxes and Heat

Portable Mortgage – A mortgage that allows for the existing terms to be transferred to a new property in the event the existing property is sold

Personal Line of Credit – A line of credit that is not secured by property. Personal lines of credit are based on a person’s credit history and income. Interest rates are typically higher than Home Equity Lines of Credit (HELOCs)

Pre-approval – A cursory look at a person’s income and credit to determine if they qualify for a mortgage and if so, how much money they can potentially borrow

Prepayment Penalty – The penalty levied by a lender for paying a closed mortgage in full prior to the term maturity date

Prepayment Privileges – A borrower’s right to make extra payments to reduce or eliminate a mortgage balance prior to the maturity date of the mortgage

Primary Residence – A person’s main residence

Principal – The mortgage balance owed on a mortgage

Prime Rate – The rate at which banks loan money to their most credit-worthy clients. Variable rate mortgages are priced off of the prime rate

Private Mortgage – A mortgage provided by an individual or a company that isn’t a bank or trust company
Property Taxes – Taxes levied by government based on the assessed value of a property and the applicable rate of taxation, called the mill rate

Proven Income – Income that can be verified by third-party documentation such as tax returns and pay stubs

Purchase Contract – a real estate contract that states the terms of the agreement including price, conditions and completion date for the sale of a property

Re-advanceable Mortgage – A mortgage product comprised of two mortgage components, usually a mortgage and a secured line of credit. Money paid down on the mortgage component can be accessed through the line of credit since the line of credit limit increases proportionately

Refinance – Renegotiating an existing mortgage

Renewal – The extension of a mortgage loan by a lender, possibly under new terms

Reverse Mortgage – A mortgage that allows senior citizens to access equity in a property without qualifying income or credit. Reverse mortgages do not require interest payments and can be paid in full upon the sale of the property

Second Mortgage – A mortgage that is registered on a property title in second position behind a first mortgage

Soft Inquiry – A credit inquiry initiated by a person who wants to know his or her own credit score. Soft inquiries do not impact credit scores
Stated Income – Personal income declared by self-employed applicants that is not verified by third-party documentation

Term – The period of time a mortgage contract covers

Title – The legal document that outlines the owners, creditors and encumbrances for a particular property

Title Insurance – Insurance coverage that protects against defects and ownership challenges on a property’s title. Title insurance is offered by private title insurance companies

Total Debt Servicing Ratios – A ratio determined by adding the Principal, Interest, Property Taxes, Heat and 50 per cent of the Condo Fees (if applicable) as well as other monthly debt obligations, and dividing the sum by a borrower’s gross monthly income

Underwriters – Lender employees who analyze borrowers’ applications and determine whether or not the application is approved

Utilization Rate – The amount of money that has been borrowed against the total available amount of money on a line of credit, loan or credit card

Variable Rate Mortgage – A mortgage that has an interest rate that may increase or decrease depending on the prime rate
BE PREPARED when you talk to your mortgage broker. You’ll reduce your stress level and speed up the approval process by having documents gathered ahead of time.

Document Checklist for Salaried/Hourly Clients

Typical documents include:
- Pay stub – must be within 30 days of application
- Job letter – must be within 30 days of application, be on company letterhead, confirm income and job tenure
- Void cheque
- Real estate agent’s contact information
- Purchase contract
- Real estate agent’s property listing
- Proof of down payment (3 months of bank statements which must state applicant’s name and account number. If stating income, proof of the source of large deposits must be provided)
- Lawyer’s contact information
- If applicable – current mortgage statement with address(es) on existing property or properties
- If applicable – proof of unpaid debts (collections) paid out
- If applicable – gift letter and proof of gift being deposited into bank account
- If applicable – builder plans and New Home Warranty enrollment number
- If applicable – lease(s) for rental property or properties
- If applicable – separation or divorce agreement outlining alimony or child support paid or received
Document Checklist for Self-Employed Clients

Typical documents include:

- Two years of Notice of Assessment for self-employed individuals proving income
- Two years of company financials are often required
- Void cheque
- Real estate agent’s contact information
- Purchase contract
- Real estate agent’s property listing
- Proof of down payment (3 months of bank statements which must state applicant’s name and account number. If stating income, proof of the source of large deposits must be provided)
- Proof of self-employed status (usually two years proof needed by way of business licenses, GST returns or articles of incorporation)
- Two years of T1 Generals if sole proprietorship or partnership
- Lawyer’s contact information
- If applicable – current mortgage statement on existing property or properties
- If applicable – current leases on all existing rental properties
- If applicable – Proof of unpaid debts (collections) paid in full
- If applicable – Gift letter and proof of gift being deposited into bank account
- If applicable – Builder’s plans and New Home Warranty enrollment number
- If applicable – separation or divorce agreement showing alimony and child support payments paid or received
When Jason Scott went to the bank to get his first mortgage, $89,000 seemed like a staggering debt. The young freelance photographer knew little about fixed or variable rates, amortizations, or repayment strategies that could impact the long-term cost of owning a home. For years afterward, he wondered if he had received good advice or had asked the right questions.

Now as an experienced mortgage broker, Jason is dedicated to helping homeowners find the best mortgages for their needs and budgets. Whether you’re a first time buyer or hoping to soon retire, this easy-to-read book provides insight into the complicated Canadian mortgage landscape.

DISCOVER
- How to avoid costly financing mistakes
- How to save money when renewing your mortgage
- What you need to know if you’re self-employed
- What to do when the marriage ends
- The truth about reverse mortgages
- When to refinance to save money

JASON SCOTT is an Edmonton-based mortgage broker with TMG The Mortgage Group. For information on his services, visit edmontonmortgagebroker.com

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