Mortgage Terminology

Trying to make decisions regarding your mortgage can seem a little overwhelming if you are not comfortable with the terminology. Below are some of the common terms you are likely to hear. If you are meeting with your mortgage broker and you are not clear about the discussion, it is important to ask for clarification. We like to have time to work with our clients before we sit down with an accepted offer, to make sure they have a solid understanding of the decisions they will be making.

It is really important that you make decisions based on your personal circumstances. Taking the time to educate yourself upfront may save you thousands of dollars over the long run!

AMORTIZATION:

Amortization refers to the length of time it takes to completely pay off your mortgage. For high ratio mortgages, the maximum amortization allowed is 25 years, and for conventional mortgages this extends to 30 years. It is to your advantage (in most cases) to choose the shortest amortization you are comfortable with as you will pay less interest in the long run.

TERM:

The actual length of time money is loaned at the contractual rate of interest. Terms range from three months to twenty-five years. Traditionally the longer the term, the higher the rate.

CONVENTIONAL:

Regulations under The Bank Act prohibit Bank, Trust and Insurance Companies from lending in excess of 80% of the purchase price or the appraised value of a property without obtaining Mortgage Loan (High Ratio) Insurance. A loan for up to 80% of the purchase price of a property is a *conventional mortgage*.

INSURED / HIGH RATIO:

A mortgage for 80.1% to 100% of the purchase price of a property is deemed high ratio. All high ratio mortgages are subject to a premium (mortgage loan insurance - you may hear this referred to as a CMHC or Genworth premium). This premium is calculated on a sliding scale

depending on how much you put down on your mortgage. Most home buyers choose to add this amount to their mortgage.

MORTGAGE LOAN INSURANCE (high ratio):

High ratio mortgages must be insured through CMHC (Canada Mortgage and Housing Corporation), Genworth Financial Canada, or Canadian Guarantee. CMHC, Genworth and Canadian Guarantee provide default or high ratio insurance to the lenders protecting them against the risk of lending to homebuyers who have less than 20% down payment available.

The insurance premium is paid by the borrower on behalf of the lender. The insurance premium that is paid to the mortgage insurer is to protect the lender in the event that the mortgage is not paid. This is not to be confused with life, disability, or job loss insurance.

FIRST MORTGAGE:

Mortgage given first priority at the registry office. Most borrowers only have one mortgage on their property, but in the event of default or other collection actions, the first mortgage holder has priority over any other claims.

SECOND MORTGAGE:

A higher interest rate loan that provides borrowers with additional financing if the first mortgage does not meet their total financial requirements. Second mortgages are generally expensive to set up and charge higher rates of interest.

OPEN MORTGAGE:

With an open mortgage, the entire principal or any part of it can be prepaid to the lender at any time without having to pay any penalty or bonus interest to the lender. The length of the term is generally 6 months to 1 year, although some banks have introduced 5-year open terms.

HOME EQUITY LINE OF CREDIT:

A Home Equity Line of Credit (HELOC) is a revolving line of credit that is secured by your home. As the line of credit is secured by your home, the risk of repayment to the lender is reduced and reflected in the rate. A HELOC interest rate will be much lower than a personally secured loan. The maximum amount for a HELOC is 65% of your home’s value. When this is combined with a fixed portion of your mortgage the total loan-to-value cannot exceed 80%. With a HELOC mortgage product you can draw on the funds at any time and repay them at any time without penalty.

CLOSED MORTGAGE:

These types of mortgages have a fixed term. If you were to pay out your mortgage before the mortgage maturity the lender would charge an early payout penalty. The amount of this penalty will vary, but generally it is 3 months interest or interest rate differential calculation whichever is greater.

CONVERTIBLE MORTGAGE:

You can get the low rate typically associated with the short term, but the freedom to lock in at any time for longer, if you think rates are headed up. To win, however, you've got to be an assiduous rate-watcher. These mortgages are usually offered with a 3-month, 6-month or 12-month term.

VARIABLE RATE MORTGAGE (VRM):

A loan whose interest rate fluctuates with the Prime Rate. Prime Rate is a suggested rate by the Bank of Canada and is largely affected by the Bank Rate. A variable rate for your mortgage will be presented as a discount or premium to the Prime Rate.

This rate can fluctuate monthly, but is most likely to fluctuate quarterly as a result of the Bank of Canada announcing the Bank Rate. VRMs are handy mortgages when rates are falling because those rate breaks get passed along quickly as rates are adjusted. However, if you fail to act quickly when rates begin to rise, you may also miss the chance to switch to a fixed-term mortgage. Increases in interest rates could create problems if your VRM monthly payment doesn't include any cushion for rate hikes. In that case the lender may require you to increase your payment to prevent a "deficit interest" situation.

BENCHMARK RATE:

The Benchmark Rate is set by the Bank of Canada. Lenders are required to use this rate to qualify borrowers. It is approximately 2% higher than current mortgage rates. The intent behind this is to ensure borrowers are able to carry higher payments should interest rates rise.

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