Everything You Need to Know as a First-Time Homebuyer

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SMART DEBT MORTGAGES

A Guide to Buying Your First Home

So, you've decided to take the plunge and make one of the biggest steps of adult life – purchasing your first home! Before you pop the champagne and start planning your housewarming party, there are a lot of important steps to follow throughout this process, and things to consider along the way.

To help you navigate this exciting time in your life, we've compiled all our expert knowledge on the topic and will go over everything you need to know before you meet with a mortgage broker and start putting in offers.

Determining What You Can Afford

Perhaps the most important thing you'll need to do before you start looking at houses is determining what mortgage payments you can afford, as this will determine what price range you can consider.

A mortgage broker can help you with this by examining your debt to income ratio and your down payment.

Keep in mind that ideally, your total monthly housing costs (including mortgage payments, hydro, water, etc.) should be 39% of your gross household income or less. Also remember to add condo fees to your calculations if you are looking at condominiums.

Your debt payments should also ideally be no more than 44% of your monthly income.

Coming Up with a Down Payment

Often one of the most difficult parts about buying a home is saving up enough money to use as a down payment.

Lenders require only a minimum of 5% of a home's sale price for a down payment, however, if you have the money to do so, it's recommended that you put down more to help reduce your mortgage payments and secure more equity right off the bat. Also keep in mind that any amount under 20% requires you to obtain default insurance.

When it comes to saving up for a down payment, this can be difficult to do, which is why many first-time homebuyers receive financial help from a family member. While this is a great way to come up with the money for a down payment, it's important to note that lenders require more than just a down payment in order for you to qualify for a mortgage. You will also need to show that you can afford the mortgage payments based on your Gross Debt Service (GDS) ratio.

Many lenders will also require you to disclose where the money for your down payment came from. In many cases, if you received all or part of your down payment as a gift, then the benefactor will need to sign a letter to confirm this.

The First Time Homebuyer Incentive program is also an option to help you put more money down in order to decrease your mortgage payments.

The incentive allows you to borrow 5% or 10% of your home's purchase price from the government to be used towards your down payment.

You will also need to come up with at least 5% for your down payment (if you are purchasing an existing home), which the government will match to bring your down payment up to 10%. If you are purchasing a brand new home, you will get 10% from the government on top of your 5%, bringing your total down payment up to 15%.

The result is a shared equity mortgage, which means you must repay the same percentage of your home's value that you borrowed from the government upon selling or within 25 years, whichever comes first. This means that if the value of your home increases, the amount you have to repay will increase.

For example, let's say you purchased your home for $300,000 and borrowed 5% of that ($15,000) through the First Time Homebuyer Incentive. By the time you are ready to sell, your home's value may have increased to $350,000. This means that the amount that you have to repay has increased to $17,500.

Qualifying for a Mortgage

For first-time homebuyers with a steady income and good credit, qualifying for a mortgage with the best rates and terms is typically not very difficult.

When evaluating borrowers, lenders look at a few key factors, like:

- Your down payment
- Your annual and monthly income
- Assets
- Debt load
- Credit history

So, if you have bruised credit and irregular income, this could potentially be seen as a red flag for borrowers. If you are concerned about qualifying for a mortgage, speak with a mortgage broker about your options.

Obtaining Pre-Approval

When shopping for homes in a hot real estate market, you will likely be facing a lot of competition when putting in offers. For this reason, it's important to make your offer as appealing to the seller as possible. One way to do this, besides offering above asking price, is to obtain pre-approval for a mortgage.

Pre-approval is when a lender states in writing that you have qualified for a mortgage loan of a certain amount based on your income and credit history and that they are willing to give you a loan. This is a great way to make your offer stand out, as it assures the seller that there is a low risk of you having to back out of the sale during the conditional period due to lack of financing.

Considering Different Types of Mortgages

Fixed Vs. Variable

Fixed interest rates remain the same for the entire duration of your mortgage term. Fixed interest rates tend to be higher than variable interest rates, but can be beneficial as:

- Your payments are guaranteed to remain the same and will not change over time unless you choose to increase them
- You'll know ahead of time how much of your mortgage (principal) will be paid off at the end of your term

Variable interest rates, on the other hand, tend to be lower than fixed, but can increase and decrease throughout your term as the market fluctuates. This can be beneficial, as it can mean lower payments when rates are low. However, if rates spike, your payments can end up being significantly higher.

Different Term Lengths

Most lenders offer terms that range from 1 to 10 years. However, most lenders also have three primary terms that are priced competitively, the 3-year fixed, 5-year fixed, and 5-year variable.

Amortization

While you can have an amortization between 5 and 30 years with best rate lenders, the most common amortization is 25 years or 30 years. However, it's important to note that the 30 year amortization is only available if you have more than 20% of the purchase price as a down payment.

Keep in mind that your amortization period affects your mortgage payments, so if you have a shorter amortization, your payments will be higher. Also remember that a longer amortization period means lower payments, but you end up paying more in interest in the long run.

Open Vs. Closed

The main difference between open and closed mortgages is the amount of flexibility you have to pay your mortgage off in full.

The open mortgage allows you to pay the mortgage off in full at any time without any mortgage penalties. It also usually has a much higher interest rate. However, with an open mortgage, interest rates tend to be higher than closed.

Open mortgages are typically only used in very specific cases where the mortgage loan will be paid off very quickly. Around 99% of mortgages are considered closed mortgages.

With a closed mortgage, you typically don't have this kind of flexibility, as the amount of extra money you can put towards your mortgage is often limited and paying your mortgage off in full may come with a prepayment penalty.

An upside is that closed mortgages tend to have lower interest rates than open.

Most mortgages today are closed with pre-payment privileges, however, many lenders will allow you to pay 15% to 20% of the original mortgage amount each year on top of your normal payments. They may also allow you to increase your monthly payments by 15% to 20% of the previous monthly payment.

Closed mortgages with prepayment privileges are often flexible enough for most borrowers as they enable you to pay off your house in fewer than 5 years. However, most Canadians do not have the financial means to do this.

Costs and Fees

The cost of purchasing a home is more than just your down payment. There are legal fees, transfer fees, disbursements, and other fees known as closing costs.

Closing costs are due on the day the buyer officially takes ownership of the home. Lenders usually want to see that you have 1.5% of the purchase price in savings on top of your down payment to go towards closing costs.

As a first-time homebuyer, you may be eligible for the Ontario Land Transfer Tax Rebate, which provides first-time homebuyers with a discount on land transfer tax up to $4,000. If your land transfer tax comes out to more than $4,000, you will need to pay the remaining balance.

Here is an overview of closing costs you can expect:

- Land Transfer tax – (If more than $4,000). See Ottawa land transfer tax calculator.
- Legal fees – Between $1,500 to $2,200.
- 8% tax on default insurance – If you purchased with less than 20% down payment.
- Property tax adjustment – If the seller has paid for property taxes for the entire year already, then you will need to reimburse them for the amount of days you will own the property. ***For example,*** *if the annual cost is $1,200 and you take possession July 1st and taxes are already paid for in full, then you would have to reimburse the seller for $600.*

Benefits of Working with a Mortgage Broker

While we've provided a brief overview of some of the most important information about buying your first home, there is so much more that you'll need to learn and absorb throughout this process. For this reason, it's important to surround yourself with the right team of professionals to be your guides every step of the way – including a mortgage broker.

Helping You Benefit From First-Time Homebuyer Incentive Programs

Besides helping you obtain a mortgage, a mortgage broker can help you navigate the home buying process and explain the details of the first time homebuyer's programs available to you and how to apply.

This includes the:

- Land transfer tax discount up to $4,000
- Home Buyers Plan which allows you to use up to $35,000 of RRSPs for your down payment without being taxed
- 5% or 10% loan from the Canada Mortgage and Housing Corporation (CMHC) government incentive program

Furthermore, as a first time home buyer, we would love to see you represented only by the best professionals in the industry. If you would like, we can introduce you to various professionals including a:

- **Realtor –** We can introduce you to a genuine professional who specializes in your particular price point and type of home or neighborhood that you are looking to buy in.
- **Lawyer –** Most lawyers have similar fees, so its best you work with the lawyers who offer the best service. We can refer you to lawyers we've worked with in the past and can vouch for their services and professionalism.
- **Home Insurance Broker –** Similar to a mortgage broker, you should be looking for the lowest cost when it comes to home insurance, but you also want to ensure you are adequately covered. We can help make sure that you work with someone who will keep you protected.

The Takeaway

When beginning your search for your first home, speak with an experienced mortgage broker right away who has the knowledge and expertise to help you navigate the process of obtaining a mortgage from pre-approval to closing.