




MODULE 5

MORTGAGES

OVERVIEW

This module invites students to understand how a home purchase is financed or an existing home is refinanced. Financing a new home or refinancing an existing home is very similar, if not the same process. Because the term of a mortgage is shorter than what is required to pay off the amount mortgaged completely, an existing home must be refinanced at the end of the term to come up with what is left to be paid, commonly called a balloon payment. Students will be introduced to critical concepts and the terminology used in the financing world. A mortgage, also known as a “Charge”, is an agreement to borrow money, typically from a bank; however, a lender can be anyone who has money to lend, including a family member or business person. This agreement is a negotiated one although there is an old maxim that says: “the one who has the money makes the rules.” Borrowers should nonetheless research what is available in the marketplace. Understanding what is available will put you in a better situation to negotiate.

Learning Objectives

- To introduce students to key financial literacy issues in the real estate context, particularly mortgages.
- To enhance students’ understanding of the essential concepts related to mortgages, such as down payments, interest rates, amortization periods, and payment schedules, as well as the factors considered in qualifying for a mortgage.
- To provide students with a participatory and experiential learning opportunity.
- To enhance students’ critical-thinking and advocacy skills.
- To introduce, expand, and enhance the students’ financial literacy skills.

- Copies of the *Negotiation Plan* (one per student)
- Copies of the *Mortgage Agreement* (one per pair)

Teaching and Learning Strategies

1. Introduce the topic of mortgages by having students view the video *What is a Mortgage?*, available here: https://www.youtube.com/watch?v=CBIJwb37O_4.
2. Provide an overview of basic mortgage concepts, the factors considered in qualifying for a mortgage and the terms typically addressed when negotiating a mortgage by having students review the handout, *Understanding Mortgages*. Check for understanding and clarify any points that are unclear. Consider having students explore the Mortgage Qualifier Tool (go to *Mortgage Qualifier Tool: Financial Consumer Agency of Canada* - <http://itools-ioutils.fcac-acfc.gc.ca/MQ-HQ/MQ-EAPH-eng.aspx>) either online or by printing some of the sample scenarios and reviewing them as a class.
3. Have students complete the worksheet *Understanding Mortgages - Terminology exercise* either individually or in pairs. Take up the answers as a class.

Materials

- Copies of *Understanding Mortgages* (one per student)
- Copies of *Mortgage Math: Payment Types, Amortization, and Amortization Schedules* (one per student)
- Copies of the *Confidential Instructions for Mortgagor* (one for each mortgagor)
- Copies of the *Confidential Instructions for Mortgagee* (one for each mortgagee)
- Copies of the *Negotiation Timeline* (one per student)



Teacher's Key – Understanding Mortgages - Terminology

Term	Definition
1) Amortization Period	n) The period of time it will take to pay off a mortgage in full.
2) Blended Mortgage	z) A combination of two mortgages, one with a higher interest rate than the other, to create a new mortgage with an interest rate somewhere between the two original rates. Often seen when buying a new home and an existing mortgage remains.
3) Blended Payments	v) Payments made up of principal and interest components.
4) Closed Mortgage	g) A mortgage that you cannot prepay or change before the end of the term.
5) Collateral Mortgage	j) A loan, often for something other than the purchase of your main home (e.g., home renovations, the purchase of a second home, or a business venture) that is secured against your home. Often, a collateral mortgage is registered to secure a line of credit.
6) Conventional Mortgage	cc) A first mortgage issued for up to 80% of the property's appraised value or purchase price, whichever is lower.
7) Debt Service Ratio	e) Measure used by lenders to qualify a borrower for a mortgage, being the percentage of a borrower's gross income that can be used for housing costs, including mortgage payment and taxes (and condominium fees, where applicable).
8) Discharge of Mortgage	aa) Once the mortgage has been completely paid, the lender must register evidence that it has been paid on title to the property. The registration has the effect of removing the lender's registered interest in the property.
9) Down payment	r) The amount of money the buyers contribute to the purchase of the property on closing. This may be as little as the deposit, but generally includes further monies paid on closing to be at least 5% of the value of the property.
10) Equity	w) The current market value of a home or property minus the amount remaining on any mortgages.
11) Fixed Interest Rate Mortgage	b) A mortgage with an interest rate that does not change during the term.
12) Fixed payments	f) Payments that do not change even if the mortgage interest rate changes.
13) Foreclosure	i) A legal process by which the lender takes possession and ownership of a property when the borrower defaults on the mortgage obligations – this is a court process.
14) High Ratio Mortgage	c) A mortgage for more than 80% of a property's appraised value or purchase price. Many lenders are prohibited from lending over 80% of value, unless the mortgage is insured.
15) Interest	k) The amount you pay a lender for the use of the lender's money.
16) Line of Credit	bb) A loan that is usually used for something other than the purchase of a home (e.g., home renovations). It may be secured (e.g., with a "collateral mortgage") or unsecured. You can "withdraw" the full amount at one time or use smaller amounts up to the full amount of the loan. The lender charges interest on the total amount withdrawn and not yet repaid.



Term	Definition
17) Maturity Date	d) The date when the mortgage must be either paid in full or another term negotiated through a renewal agreement. Also called Balance Due Date.
18) Mortgage / Charge	x) A loan registered on title providing the lender security for repayment with direct rights against the property in the event of non-payment, such that in the event of default the lender can sell the property to recover the money owed. Mortgage is the old terminology and Charge is the new term.
19) Mortgage Approval	o) Written approval from the mortgage lender, indicating how much money will be advanced under the mortgage and what conditions must be met for the mortgage. Also called Commitment Letter.
20) Mortgage Insurance	dd) Government-backed or private-backed insurance protecting the lender against the borrower's default on high ratio (or other types) of mortgages, issued by Canada Mortgage and Housing Corporation (CMHC), Genworth Financial Inc., or Canada Guaranty Mortgage Insurance Company).
21) Open Mortgage	h) A mortgage that you can prepay at any time during the term, without charge/penalty.
22) P.I.T.	u) Principal, interest and taxes. If property taxes are included in your mortgage payments, these three components will make up the regular payment on your mortgage.
23) Power of Sale	p) A legal process by which the lender can sell a property when the borrower defaults on the mortgage obligation – this is called a self-help process as it does not involve the courts.
24) Pre-payment Penalty	m) A penalty imposed in accordance with the terms of the mortgage when a mortgage is paid off before it comes due (i.e. end of the term), often representing three months interest or the interest differential between the rate in the mortgage being paid off and the then existing rates.
25) Pre-payment Privilege	y) A mortgage feature that allows the borrower to repay a portion or all of the principal balance with or without penalty. This privilege is frequently restricted to specific amounts as a percentage of the principal and when it can be exercised (e.g., 10% once per year).
26) Principal	s) The amount of the loan.
27) Second (and Third) Mortgages	q) A mortgage registered on title after the first mortgage, so the second mortgage lender's rights are secondary to the rights of the first mortgage lender.
28) Term	t) The length of time your mortgage agreement will be in effect.
29) Variable Interest Rate Mortgage	l) A mortgage with an interest rate that can change during the term.
30) Variable Payments	a) Payments that may change as interest rates change.



4. Introduce students to the different mortgage payment types and how they impact on the amortization by having students review the handout, *Mortgage Math: Payment Types, Amortization, and Amortization Schedules*. Have a general discussion to canvass the advantages or disadvantages that each payment method presents and circumstances in which would one choose one payment method over another. The goal is for students to appreciate that they may need or want different payment methods

over the life of a loan, depending on the reason or circumstances in which they are borrowing the money. There is no correct method, simply one that better suits the borrower in his/her circumstances at that time. Have students complete the “Mortgage Math” calculations and answer the questions. Consider modelling the initial calculation of monthly interest and principal breakdown for the entire class to ensure that students understand how to complete the calculations. Take up the answers as a class.

Teacher's Key – Mortgage Math: Payment Types, Amortization, and Amortization Schedules

1) Calculations

PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
0	-	-	\$150,000.00
1 (\$709.87)	\$375.00	\$334.87	\$149,665.13
2 (\$709.87)	\$374.16	\$335.71	\$149,329.42
3 (\$709.87)	\$373.32	\$336.55	\$148,992.88
4 (\$709.87)	\$372.48	\$337.39	\$148,655.49
5 (\$709.87)	\$371.64	\$338.23	\$148,317.26
6 (\$709.87)	\$370.79	\$339.08	\$147,978.18
7 (\$709.87)	\$369.95	\$339.92	\$147,638.26
8 (\$709.87)	\$369.10	\$340.77	\$147,297.48
9 (\$709.87)	\$368.24	\$341.63	\$146,955.86
10 (\$709.87)	\$367.39	\$342.48	\$146,613.37
11 (\$709.87)	\$366.53	\$343.34	\$146,270.04
12 (\$709.87)	\$365.68	\$344.19	\$145,925.84



Total Annual Paid:	\$8,518.44
Total Interest Cost:	\$4,444.28
Total Principal Paid:	\$4,074.16
Outstanding Principal Owing:	\$145,925.84
Total Interest Cost as Percentage of Total Annual Paid:	52.2%
Total Principal Paid Off as Percentage of Total Annual Paid:	47.8%

2) In what ways are the terms of Mortgage 2 different from Mortgage 1? What might be the reasons for this difference?

- Interest Rate. Mortgage 2 is 3% instead of 5%. Reasons could include that it is the going market rate and/or that the borrower has excellent credit rating and history.

- Monthly Mortgage Payment: Mortgage 2 is \$709.87 instead of \$876.00. Reasons could include that a lower interest rate means more money goes to pay off principal each month meaning less money is needed in order to pay off the entire loan over the same 25 year period of time.

3) Compare and contrast Mortgage 2 and Mortgage 1. Which mortgage is the better deal for the borrower? In what way(s) is it a better deal?

Mortgage 2 is the better deal based on the following:

- Lower monthly/annual mortgage payments: less money used to pay the mortgage meaning the borrower has more money to

save/invest/use to purchase other items.

- Lower interest costs/more principal paid off after 1 year: less money going to the bank and more going to reduce the principal meaning more money for the borrower.
- Lower remaining principal owing after 1 year (even though lower monthly payments): less debt is always a good thing.



4. Explain to students that they are going to be completing a mock negotiation of a mortgage. If needed, have them review the “Negotiating a Mortgage” section of the *Understanding Mortgages* handout. Organize students into pairs, with one person playing the role of the mortgager and the other the mortgagee. Distribute the *Negotiation Timeline*, *Negotiation Plan*, and *Mortgage Agreement* to each pair and explain to students that they will complete this document in pairs once they have negotiated the final terms of the agreement. They will need to complete the same calculations as they did for the amortization exercise.
5. Distribute the *Confidential Instructions for Mortgagor* separately to students playing the role of the borrower and the *Confidential Instructions for Mortgagee* to students in the role of the lender. Provide students with time to review the instructions and facts outlined in their memos.
6. Before beginning the negotiation. Give them time to develop their negotiation strategy and tactics, and complete all portions of the *Negotiation Plan* with the exception of the section on the final agreement. Have students refer to the *Introduction to Negotiation* handout from Module 2 as needed.
7. Have students negotiate the mortgage agreement using the strategies, tactics and techniques they have learned about. Follow the *Negotiation Timeline* and give students about 30 minutes to complete the negotiation and the *Mortgage Agreement*. Once they are finished, they should also complete the final portion of the *Negotiation Plan*.
8. Have students review their agreements with other pairs and compare their calculations. Take up the activity as a class, noting points of similarity and difference between groups in terms of final agreements, strategies and techniques.
9. As an additional exercise, in class or as homework, have students research what mortgages are available and at what terms. They simply need to go online at bank, credit union, and mortgage broker websites and see what offers are available for residential mortgages. When presenting in class, students should discuss the options (open vs. closed mortgages; variable rate vs. fixed rate; etc.) and the advantages and disadvantages of each as they see them. They should also compare the rates and terms available for the same amount of money from the various sources. A good discussion would centre on how this exercise would benefit them if they had to negotiate a mortgage now, or in the near future.

Extension

Have students review the article, *Nine Ways to Power-Save Your Way to a Down Payment*, available here: <http://www.theglobeandmail.com/globe-investor/personal-finance/mortgages/power-save-your-way-to-a-down-payment/article19699274/>, and write a reflection of the strategies that they would use to save a down payment to put towards a house.

MODULE 5

MORTGAGES

UNDERSTANDING MORTGAGES

ESSENTIAL CONCEPTS

Mortgage – A mortgage (also called a “charge”) is a type of loan registered on title providing the lender security for repayment with direct rights against the property in the event of non-payment or other breach of the mortgage terms, such that in the event of default, the lender can sell the property to recover the money owed. A mortgage is a promise to repay together with the grant of security in real estate. Under a mortgage, the borrower (“mortgagor”) is responsible for making regular payments to the lender (“mortgagee”). The payments are known as “blended” in that they cover the interest on the loan plus part of the principal (i.e., the total outstanding amount of the loan). Payments may also include property taxes, insurance, and similar charges.

A mortgage is a unique kind of loan because it allows a lender to sell or take over ownership of the property if the borrower does not pay on time (i.e., “default”). Because the lender enjoys this right, we say that the property is “security” since it gives the lender peace of mind that if the borrower fails to pay, the lender will be able to recoup most if not all of its money (e.g., by taking possession and selling the house).

Mortgagor – The borrower is called the “mortgagor” because he/she borrows the money and gives the mortgage to the lender (“mortgagee”). Although this is the popular term, legally a mortgage is now known as a charge and the mortgagor, the chargor.

Mortgagee – The lender is called the “mortgagee” because it lends the money and receives the mortgage from the borrower (“mortgagor”). Although this is the popular term, legally a mortgage is now known as a charge and the mortgagee, the chargee.

Down payment – Most people cannot purchase a home without financial assistance, such as a mortgage. Lenders generally insist that the homeowner has equity in the property. This equity, commonly known as the “down payment”, is contributed by the buyer partly as the deposit in the agreement of purchase and sale and the balance of personal funds delivered on closing. The down payment is often described as a percentage of the purchase price. In Canada, the minimum down payment for residential properties is 5% but some lenders require more. The down payment is essentially the “cash” which the buyer pays out-of-pocket to purchase the property. The rest of the money comes from the “bank” in the form of a loan (“mortgage”). The larger the down payment you pay, the less interest you will pay over the life of the mortgage. Also, if your down payment is less than 20% of the purchase price, you will have to purchase mortgage insurance, which is a kind of insurance which protects the lender in case you can’t pay. Mortgage insurance can be a significant additional cost; generally the premium is added to the capital and paid as part of the entire mortgage.

Principal/Interest – The actual money which is borrowed in a mortgage is called the “principal”. “Interest” is what the lender charges the borrower for borrowing this money. You can think of interest as rent on the use of someone else’s money. When you make a mortgage payment, the lender uses it first to cover the interest. Then anything left over goes to the principal and in some cases to taxes and insurance. At the beginning of the term, generally only a small amount goes to the principal, but gradually more of the payment goes to the principal until the mortgage is fully paid off. The key to saving money on your mortgage is to pay off the principal as



fast as possible. If you can make extra payments under the terms of your mortgage, the lender will apply them directly to the principal. By reducing the principal, you can save thousands, or even tens of thousands, of dollars in interest charges.

Equity – “Equity” is what the borrower actually owns in a mortgaged property. The rest is effectively the bank’s money. Equity is calculated by subtracting the outstanding amount of the loan owed under the mortgage from the market value of the property at a given date. Equity consequently increases as the principal is reduced (via each monthly payment) and as the property appreciates (via market-driven increases in value). Equity can also diminish such as when property values shrink.

Mortgage Term – In Canada, lenders are not prepared to lend their money on the same rate and terms for the period of time it would take to fully repay it.¹ The “mortgage term” is the length of time of the agreement between the borrower (“mortgagor”) and lender (“mortgagee”). Both the borrower and lender agree to live with the same terms for that period of time (e.g., a mortgage amortized over 25 years may only have a term of five years). At the end of the term, the borrower has to repay the balance of the mortgage, which is called a “balloon payment”. However, when the term is up, lenders will often extend the option to renew the mortgage for a new term at the best interest rate then available. Alternately, you can look for a better deal from other lenders, get a new mortgage loan, and then use this money to pay off the previous mortgage through the arrangement with the new mortgage lender.

Mortgage Principal Amount	\$100,000
Term	5 years
Number of Payments/Payment Frequency	60/Monthly
Interest rate	5%
Amortization Period	25 years
Total Interest Paid Over Five Year Term (Paid to the ‘Bank’)	\$23,404
Total Principal Paid Over Five Year Term (Owned by Borrower as ‘Equity’)	\$11,493
Principal Balance After Five Year Term (Outstanding Debt Owed to the ‘Bank’)	\$88,507

¹In Canada, terms are typically for 1, 2, 3, 4, 5, 7 or 10 years, although different lengths might be occasionally available. In the United States mortgage terms can be the same as the amortization period.



Amortization Period – The “amortization period” is the length of time it would take to pay off the mortgage in full, based on regular payments at a certain interest rate. A longer amortization period means you will pay more interest than if you got the same loan with a shorter amortization period. However, the benefit is that the mortgage payments will be lower, so some buyers prefer longer amortization periods to make the payments more affordable. Usually, the amortization period is 25 years but can be shorter, say 15 or 20 years. It is generally advantageous to choose the shortest amortization period—that is, the one with largest mortgage payments—that you can afford. This way you can pay off your mortgage faster and save thousands or even tens of thousands of dollars in interest.

Mortgage amount	\$100,000	\$100,000	\$100,000
Amortization period	15 years	20 years	25 years
Number of Payments/ Payment Frequency	180/monthly	240/monthly	300/monthly
Interest rate	5%	5%	5%
Monthly blended payment	\$788	\$657	\$582
Total interest paid After 25 Years	\$41,862	\$57,710.01	\$74,482

Open/Closed Mortgages – Lenders frequently offer two types of mortgages: open and closed.

- **Open Mortgage** – With an “open mortgage”, you can make extra payments (known as prepayments) at any time. You may even be able to pay the mortgage off completely before the end of the term without having to pay any prepayment charges whatsoever. However, the interest rate on an open mortgage is usually higher than on a closed mortgage with similar terms.
- **Closed Mortgage** – A “closed mortgage” is one that you cannot prepay or change before the end of the term without penalties being charged. If you want to make changes to the mortgage during the term (for example, to take advantage of lower interest rates), you will usually have to pay a prepayment charge. The mortgage lender may let you make extra payments (known as prepayments) without charge but usually with limitations. The interest rate on a closed mortgage is usually lower than the rate on an open mortgage with similar terms. A pre-payment penalty is often equal to three months interest or the difference in interest which would have been paid on the existing mortgage to maturity and the interest the lender can get lending that sum at the then current rates. The higher the rates when the mortgage is paid off, the higher the interest differential penalty. Often it is said to be the higher of either calculation.



Interest Rates – Fixed vs. Variable – The interest rate in a mortgage may be fixed or variable.

- **Fixed Interest Rate** – With a “fixed interest rate mortgage”, the borrower agrees to a certain fixed rate of interest for the duration of the mortgage term. Because the interest rate does not change, the borrower knows exactly how much interest he/she will have to pay and how much of the original loan principal amount will be paid off during the term. The benefit of a fixed interest rate mortgage is that it provides security and a predictable budget.
- **Variable Interest Rate** – With a “variable interest rate mortgage”, the interest rate can change during the term in accordance with changes in open market interest rates. These market rates generally track the Bank of Canada Bank Rate. Between 2000 and 2009, the Bank of Canada Bank Rate varied from 6.0 percent to 0.5 percent. The interest rates on variable-rate mortgages are often lower than on fixed interest rate mortgages with the same term length, so variable interest rate mortgages may be attractive and reduce interest charges in the long term. However, it is very difficult to predict which will be the lower-cost option over the term of the mortgage. Although variable interest rate mortgages are riskier and less predictable than fixed interest rate mortgages, they do offer greater potential interest cost savings.

Payments – Fixed vs. Variable – Like interest rates, mortgage payments can also be fixed or variable. Note, however, that fixed interest rate mortgages always have fixed payments, whereas variable interest rate mortgages can have fixed payments, variable payments or a combination of both.

- **Fixed Payments** – With “fixed payments”, you pay a fixed periodic (traditionally, monthly but can also be semi-monthly, biweekly or weekly) payment amount which does not change regardless of changes in the interest rate. If combined with a variable interest rate, when the interest rate goes down, more of the payment applies to the principal and you pay off the mortgage faster. However, if the interest rate goes up, more of the payment applies to interest, and less to principal. This extends the length of time it will take to pay off your mortgage. Because the variable interest rate affects how much of each payment is applied to cover interest, you cannot know in advance how much of the principal will be paid off by the end of the term.
- **Variable Payments** – With “variable payments”, your monthly payment amount changes if the interest rate changes. If the interest rate rises, your payments also rise. Because it is more difficult to plan your mortgage payments over the term of the agreement, a borrower needs to be sure he/she can adjust his/her budget to make higher payments. However, because the amortization period stays the same, you can determine in advance how much of the mortgage will be paid off by the end of the term.

Payment Frequency – Most lenders allow borrowers to choose from a variety of payment schedules (e.g., monthly, semi-monthly (24 payments/year), biweekly (26 payments/year) or weekly). If you choose a more frequent schedule, you save money because more of your money will be applied to the principal sooner, and less interest will accumulate in total. If you can afford an “accelerated” schedule, you can get significant savings on your mortgage interest. An accelerated schedule divides your monthly payments over a weekly or biweekly schedule so that you pay an extra monthly payment each year.



MODULE 5



MORTGAGE PRINCIPAL AMOUNT		\$100,000	
TERM		25 YEARS	
INTEREST RATE		5%	
AMORTIZATION PERIOD		25 YEARS	
PAYMENT FREQUENCY	DESCRIPTION	PAYMENTS	INTEREST COST (25 YEARS)
Monthly	One payment per month for a total of 12 payments each year.	\$582/mo.	\$74,482
Semi-Monthly	- Two payments per month for a total of 24 payments each year. - The monthly payment is halved and first half applied sooner hence shrinking the interest cost.	\$291/twice per mo.	\$74,391
Biweekly	- One payment every two weeks for a total of 26 payments each year. - With this payment option, the total amount paid annually is identical to the total paid annually with the monthly payment option (monthly payment x 12 months / 26)	\$268/ every 2 weeks	\$74,384
Accelerated Biweekly	- One payment every two weeks for a total of 26 payments each year. - With this payment option, the biweekly payment amount is exactly half the monthly payment, payable every two weeks, resulting in payment of the equivalent of one extra monthly payment per year	\$291/every 2 weeks	\$62,395
Weekly	- One payment per week for a total of 52 payments each year. - With this payment option, the total amount paid annually is identical to the total paid annually with the monthly payment option (monthly payment x 12 months / 52)	\$134/week	\$74,342
Accelerated Weekly	- One payment per week for a total of 52 payments each year. - With this payment option, the weekly payment amount is exactly one-quarter of the monthly payment, payable every week, resulting in payment of the equivalent of one extra monthly payment per year	\$145/week	62,257



GETTING A MORTGAGE

FACTORS IN QUALIFYING FOR A MORTGAGE

Employment/Income – The rule of thumb is that most borrowers can afford and hence most lenders are willing to lend money for a home that runs about two and a half to three times the borrower's annual salary.

Credit Rating – Before banks extend credit, they assess the borrower's credit rating. Lenders use the credit rating to decide whether to lend money, how much, and at what interest rate. The credit rating consists of a credit report and a credit score. A credit report is a report of a person's credit history. A credit score is a number that represents the creditworthiness or the lending risk that the person represents for lenders, compared with other consumers, on a scale from 300 to 900. High scores on this scale are good. The higher the score, the lower the likelihood the person will "default" on his/her mortgage (i.e., not pay), and hence the more likely lenders will extend credit at lower rates. This score is based on an assessment of the person's character, income, economic history (e.g., duration and type of employment), debt payment history (e.g., timeliness of payments), and assets (e.g., savings or other property).

To get the best possible mortgage rate, lenders recommend a person keep his/her credit history healthy and accurate. Aim to raise a credit score above 750 in order to qualify for the best interest rates. Independent agencies, known as credit bureaus, collect and provide this information to prospective lenders whenever borrowers apply for credit. The two main credit bureaus in Canada are Equifax Canada Inc. (www.equifax.ca) and TransUnion Canada (www.transunion.com). Each offers a free copy of their credit report on request.

Loan-to-Value Ratio (LTV) – LTV is a financial measure used by lenders that helps to assess the risk of not recovering the total amount of the loan in the event the borrower defaults. It is one of the key risk factors lenders consider when qualifying borrowers for a mortgage. LTV quantifies the amount of the loan relative to the value of the asset being purchased. To calculate the LTV, divide the loan amount by the property's value. If the LTV is above 80% (in other words, less than a 20% down payment) the rates may increase significantly. Moreover, the borrower will also likely have to purchase mortgage default insurance to protect the lender from his/her defaulting, which increases the cost of the mortgage. Alternately, one can find a less expensive home or save up for a larger down payment to lower the LTV below the 80% threshold. Lenders prefer not to loan out more than 80% of an asset's value for the simple reason that doing so might result in lenders having to suffer a loss in the event the asset decreases in value on the open market. By getting borrowers to front 20% of the cost means the lender will not likely suffer any loss due to depreciation in value.

Debt-to-Income Ratio (DTI) – DTI is a financial measure used by lenders to assess the burden of an individual's debt obligations relative to his/her income. DTI is the percentage of income that goes toward paying all monthly debts. DTI is another key risk factor lenders consider when assessing borrowers for mortgages. Mortgage lenders use DTI to determine how large a mortgage the borrower can afford after all his/her monthly debts are paid. To calculate DTI, add up all monthly debts (not only mortgages) and divide by the monthly income. A DTI between 20-39% is usually considered good and will help a person be perceived as financially stable.

The Financial Consumer Agency of Canada (FCAC) has an online Mortgage Qualifier Tool² to help prospective buyers get an idea about how large a loan they would likely be approved for based on formulas lenders regularly use to evaluate mortgage loan applications. The site can give someone a realistic sense of his/her ability to pay for a mortgage. Note that when someone buys a home, he/she will also have to be ready to pay for a variety of additional expenses and taxes.

²See: <http://itools-ioutils.fcac-acfc.gc.ca/MQ-HQ/MQ-EAPH-eng.aspx>



NEGOTIATING THE TERMS OF A MORTGAGE

The following terms are typically addressed when negotiating a mortgage:

- The amount of the down payment you can pay (determines whether mortgage insurance must be obtained);
- The amortization period that will best fit your monthly budget (e.g., 15, 20 or 25 years);
- The mortgage term (e.g., 1, 3 or 5 years);
- An open or closed term mortgage;
- A fixed or variable interest rate;
- Fixed or variable payments;
- Payment frequency (e.g., monthly, weekly, biweekly or accelerated payment schedule);
- Pre-Payment option (e.g., 10% or 20% annually, double-up payments, skip a payment, etc.).

The **key factor in choosing a mortgage is what you can afford in your monthly budget**. A mortgage calculator can help you compare the costs of different mortgage options.

Traditionally, banks will post information of their mortgage for borrowers to see and consider. This is their offer. Depending on the negotiating strength of the borrower, a borrower can negotiate better conditions than posted by the banks in their windows, website or campaign. Often borrowers will simply accept the conditions offered much as we buy an item at the grocery store. However, lenders are often prepared to negotiate the conditions (i.e., the interest rate, payment schedule, term, amortization period, pre-payment, or other rights, etc.). Anyone looking to negotiate a mortgage should inquire not only of his/her regular financial institution but also of others, as only then can he/she discover if he/she is getting the best conditions. Mortgage conditions are personal to each borrower; depending on his/her risk level, income, financial situation, and life plans.

In addition to approaching a bank for a mortgage, a borrower could approach a mortgage broker to determine what conditions are available. A broker typically deals with many lenders, banks, trust companies, and private lenders. They often are a centralized option to quickly and efficiently canvass the market. There is no need to use a broker, but many find it beneficial or easier to do so.

A borrower might also shop for a mortgage based on the options that best serves him/her. For example, if someone anticipated selling his/her home, he/she would opt for a shorter term (e.g., 1 year) or an open mortgage to minimize or avoid paying any pre-payment penalties to the lender. A borrower who knows his/her income will likely increase in the years ahead will seek a mortgage with options to increase his/her payments (e.g., double-up) or offer him/her the ability to make lump sum payments (e.g., 10% of the original principal once a year, whether on a calendar year or anniversary of the mortgage), in addition to seeking a fixed term and interest rate to ensure stability in the early years.

Caution - Line of Credit

It has become very desirable and common to be approved by a lender for a line of credit. Contrary to a mortgage, which only has a declining balance (i.e., only pay off the loan and once paid, it ends), a line of credit, also called a revolving loan, permits new borrowing that can be paid off many times during its existence. The principal amount may go up or down over the years as new money is borrowed and payments are made. A line of credit may be secured or unsecured. A secured line of credit is most often a mortgage on a home. It is possible to have a regular first mortgage and if there is sufficient equity in the home, a line of credit secured as a second mortgage. Many homeowners will sign up at their bank for a line of credit and not appreciate that they are in fact giving the bank a mortgage on their home. This mortgage to secure the line of credit is often called a "collateral mortgage" and can be problematic as it might in fact be providing security for the bank to not only the line of credit but also any other indebtedness of the borrower to the bank, existing or in the future, including credit cards. When providing a mortgage or collateral mortgage to a lender it is advisable to consult with a lawyer to have the loan and mortgage documentation reviewed and explained.



UNDERSTANDING MORTGAGES - TERMINOLOGY

Match the following terms with the correct definition. Refer to the handout *Understanding Mortgages* as needed.

- **Line of Credit** • **Fixed Interest Rate Mortgage** • **Pre-Payment Privilege** • **Maturity Date**
- **P.I.T.** • **Amortization Period** • **Open Mortgage** • **Power of Sale** • **Blended Mortgage**
- **Mortgage Approval** • **Blended Payments** • **Variable Interest Rate Mortgage** • **Principal**
- **Foreclosure** • **Closed Mortgage** • **Down Payment** • **Term** • **Collateral Mortgage**
- **Discharge of Mortgage** • **Mortgage Insurance** • **Debt Service Ratio** • **Mortgage / Charge**
- **Conventional Mortgage** • **Fixed Payments** • **Variable Payments** • **Interest** • **Equity**
- **Second (and Third) Mortgages** • **Pre-Payment Penalty** • **High Ratio Mortgage**

TERM	Definition
	a) Payments that may change as interest rates change.
	b) A mortgage with an interest rate that does not change during the term.
	c) A mortgage for more than 80% of a property's appraised value or purchase price. Many lenders are prohibited from lending over 80% of value, unless the mortgage is insured.
	d) The date when the mortgage must be either paid in full or another term negotiated through a renewal agreement. Also called Balance Due Date.
	e) Measure used by lenders to qualify a borrower for a mortgage, being the percentage of a borrower's gross income that can be used for housing costs, including mortgage payment and taxes (and condominium fees, where applicable).
	f) Payments that do not change even if the mortgage interest rate changes.
	g) A mortgage that you cannot prepay or change before the end of the term.
	h) A mortgage that you can prepay at any time during the term, without charge/penalty.
	i) A legal process by which the lender takes possession and ownership of a property when the borrower defaults on the mortgage obligation – this is a court process.
	j) A loan, often for something other than the purchase of your main home (e.g., home renovations, the purchase of a second home, or a business venture) that is secured against your home. Often, a collateral mortgage is registered to secure a line of credit.
	k) The amount you pay a lender for the use of the lender's money.
	l) A mortgage with an interest rate that can change during the term.



UNDERSTANDING MORTGAGES - TERMINOLOGY

Match the following terms with the correct definition. Refer to the handout *Understanding Mortgages* as needed.

- **Line of Credit** • **Fixed Interest Rate Mortgage** • **Pre-Payment Privilege** • **Maturity Date**
- **P.I.T.** • **Amortization Period** • **Open Mortgage** • **Power of Sale** • **Blended Mortgage**
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- **Conventional Mortgage** • **Fixed Payments** • **Variable Payments** • **Interest** • **Equity**
- **Second (and Third) Mortgages** • **Pre-Payment Penalty** • **High Ratio Mortgage**

TERM	Definition
	m) A penalty imposed in accordance with the terms of the mortgage when a mortgage is paid off before it comes due (i.e. end of the term), often representing three months interest or the interest differential between the rate in the mortgage being paid off and the then existing rates.
	n) The period of time it will take to pay off a mortgage in full.
	o) Written approval from the mortgage lender, indicating how much money will be advanced under the mortgage and what conditions must be met for the mortgage. Also called Commitment Letter.
	p) A legal process by which the lender can sell a property when the borrower defaults on the mortgage obligation – this is called a self-help process as it does not involve the courts.
	q) A mortgage registered on title after the first mortgage, so the second mortgage lender's rights are secondary to the rights of the first mortgage lender.
	r) The amount of money the buyers contribute to the purchase of the property on closing. This may be as little as the deposit, but generally includes further monies paid on closing to be at least 5% of the value of the property.
	s) The amount of the loan.
	t) The length of time your mortgage agreement will be in effect.
	u) Principal, interest and taxes. If property taxes are included in your mortgage payments, these three components will make up the regular payment on your mortgage.
	v) Payments made up of principal and interest components.



UNDERSTANDING MORTGAGES - TERMINOLOGY

Match the following terms with the correct definition. Refer to the handout *Understanding Mortgages* as needed.

- **Line of Credit** • **Fixed Interest Rate Mortgage** • **Pre-Payment Privilege** • **Maturity Date**
- **P.I.T.** • **Amortization Period** • **Open Mortgage** • **Power of Sale** • **Blended Mortgage**
- **Mortgage Approval** • **Blended Payments** • **Variable Interest Rate Mortgage** • **Principal**
- **Foreclosure** • **Closed Mortgage** • **Down Payment** • **Term** • **Collateral Mortgage**
- **Discharge of Mortgage** • **Mortgage Insurance** • **Debt Service Ratio** • **Mortgage / Charge**
- **Conventional Mortgage** • **Fixed Payments** • **Variable Payments** • **Interest** • **Equity**
- **Second (and Third) Mortgages** • **Pre-Payment Penalty** • **High Ratio Mortgage**

TERM	Definition
	w) The current market value of a home or property minus the amount remaining on any mortgages.
	x) A loan registered on title providing the lender security for repayment with direct rights against the property in the event of non-payment, such that in the event of default the lender can sell the property to recover the money owed. Mortgage is the old terminology and Charge is the new term.
	y) A mortgage feature that allows the borrower to repay a portion or all of the principal balance with or without penalty. This privilege is frequently restricted to specific amounts as a percentage of the principal and when it can be exercised (e.g., 10% once per year).
	z) A combination of two mortgages, one with a higher interest rate than the other, to create a new mortgage with an interest rate somewhere between the two original rates. Often seen when buying a new home and an existing mortgage remains
	aa) Once the mortgage has been completely paid, the lender must register evidence that it has been paid on title to the property. The registration has the effect of removing the lender's registered interest in the property.
	bb) A loan that is usually used for something other than the purchase of a home (e.g., home renovations). It may be secured (e.g., with a "collateral mortgage") or unsecured. You can "withdraw" the full amount at one time or use smaller amounts up to the full amount of the loan. The lender charges interest on the total amount withdrawn and not yet repaid.
	cc) A first mortgage issued for up to 80% of the property's appraised value or purchase price, whichever is lower.
	dd) Government-backed or private-backed insurance protecting the lender against the borrower's default on high ratio (or other types) of mortgages, issued by Canada Mortgage and Housing Corporation (CMHC), Genworth Financial Inc., or Canada Guaranty Mortgage Insurance Company).



MORTGAGE MATH: PAYMENT TYPES, AMORTIZATION, AND AMORTIZATION SCHEDULES

Recall that mortgage payments can be fixed or variable. **Amortization** refers to the paying off of debt in regular installments over a period of time, and is about how long it takes to “kill” off debt (“mort” means “death” in French). An **amortization schedule** is a table or chart showing how each payment on an amortized loan (like a mortgage) goes to pay off interest and how much goes to pay down principal.

SCENARIO

Martin and Cindy have decided to buy a home. They find a quaint starter home for \$200,000 in a nice neighbourhood. Together they have saved up \$50,000 for the down payment (25% of the purchase price). They go to the bank which offers them the following mortgage terms (i.e. Mortgage 1):

MORTGAGE NO. 1:

Mortgage Principal Amount	\$150,000
Term	5 years
Number of Payments/Payment Frequency	60/Monthly
Interest rate	5%
Amortization Period	25 years (300 payments)
Monthly Mortgage Payment	\$876.00

- **Note** – 5% is the **annual** interest rate. However, mortgage lenders charge interest on the basis of the corresponding **monthly** interest rate amount. Monthly Interest Rate = 0.00416% per month (5% = 0.05 per year divided by 12 months)
- **Calculations** – To create an amortization table, multiply the principal balance by the monthly interest rate to get the monthly interest cost; subtract the monthly interest cost from each monthly payment to determine how much principal will be paid off each month, then subtract the monthly principal amount from the previous principal balance to determine the new principal balance for the next payment period.
 - Principal Balance * Monthly Interest Rate = Monthly Interest Cost
 - Monthly Payment – Monthly Interest Cost = How Much Principal is Paid Each Month
 - Previous Principal Balance – Monthly Principle Amount = New Principal Balance



PAYMENT METHODS

In order to make their monthly mortgage payment, Cindy and Martin can choose from a variety of different payment methods. These include:

1. **Traditional fixed blended payment (principal and interest);**
2. **Interest only payment;**
3. **Variable interest rate mortgage with fixed or variable payments;**
4. **Monthly, bi-monthly or weekly mortgage payments;**
5. **No interest mortgage.**

How much Martin and Cindy will spend on mortgage payments in the first year will depend on the payment type they choose. Depending on the chosen payment method, Cindy and Martin will pay more or less interest and as such the principal will be paid down at different rates. The following charts will demonstrate how much Martin and Cindy will owe to the bank after making a year of mortgage payments using various methods of payment.

TRADITIONAL FIXED BLENDED PAYMENT

The following chart demonstrates how a fixed payment on a \$150,000 mortgage is first applied to pay the interest on the outstanding balance of the mortgage and then the remaining amount is applied to pay down the principal owing to the bank. This calculation is repeated for each payment during the term of the mortgage.

PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
0	-	-	\$150,000.00
1 (\$876.00)	\$624.00	\$252.00	\$149,748.00
2 (\$876.00)	\$622.95	\$253.05	\$149,494.95
3 (\$876.00)	\$621.90	\$254.10	\$149,240.85
4 (\$876.00)	\$620.84	\$255.16	\$148,985.69
5 (\$876.00)	\$619.78	\$256.22	\$148,729.47
6 (\$876.00)	\$618.71	\$257.29	\$148,472.19
7 (\$876.00)	\$617.64	\$258.36	\$148,213.83
8 (\$876.00)	\$616.57	\$259.43	\$147,954.40
9 (\$876.00)	\$615.49	\$260.51	\$147,693.89
10 (\$876.00)	\$614.41	\$261.59	\$147,432.30



MODULE 5



PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
11 (\$876.00)	\$613.32	\$262.68	\$147,169.62
12 (\$876.00)	\$612.23	\$263.77	\$146,905.84

Total Annual Paid:	\$10,512.00
Total Interest Cost:	\$7,417.84
Total Principal Paid:	\$3,094.16
Outstanding Principal Owing:	\$146,905.84

INTEREST ONLY PAYMENT

In this scenario, the borrower only pays interest on the outstanding amount and nothing to reduce the outstanding balance. The advantage is lower regular payments; however, the amount owed always remains and will eventually have to be paid. Many lenders offer this option and it might be advantageous to opt for this method for short term debt, especially if the borrower anticipates having a large influx of funds to pay off the entire amount (i.e., sale of an asset or bonus from work).

\$150,000 X 5% / 12 MONTHS = \$625.00/MONTH

PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
0	-	-	\$150,000.00
1 (\$625.00)	\$625.00	\$0.00	\$150,000.00
2 (\$625.00)	\$625.00	\$0.00	\$150,000.00
3 (\$625.00)	\$625.00	\$0.00	\$150,000.00
4 (\$625.00)	\$625.00	\$0.00	\$150,000.00
5 (\$625.00)	\$625.00	\$0.00	\$150,000.00
6 (\$625.00)	\$625.00	\$0.00	\$150,000.00
7 (\$625.00)	\$625.00	\$0.00	\$150,000.00



PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
8 (\$625.00)	\$625.00	\$0.00	\$150,000.00
9 (\$625.00)	\$625.00	\$0.00	\$150,000.00
10 (\$625.00)	\$625.00	\$0.00	\$150,000.00
11 (\$625.00)	\$625.00	\$0.00	\$150,000.00
12 (\$625.00)	\$625.00	\$0.00	\$150,000.00

Total Annual Paid:	\$7,500.00
Total Interest Cost:	\$7,500.00
Total Principal Paid:	\$0.00
Outstanding Principal Owing:	\$150,000

VARIABLE INTEREST RATE MORTGAGE WITH FIXED OR VARIABLE PAYMENTS

In this scenario, the interest rate is not fixed for the duration of the term, but rather goes up and down with the market conditions. This is advantageous in a market where interest rates remain constant or are declining. However, in a market where interest rates rise, the payments increase over time and may be problematic for a person with limited cash flow. With a variable regular payment, the amount dedicated to pay down the principal may remain the same, but the complete payment changes to meet the varying interest rate component of the payment. With a fixed rate regular payment, the regular payment will remain the same with more or less being applied to pay down the principal after the interest portion is paid. In mortgages, lenders always apply any payment first to interest and then to principal.

VARIABLE PAYMENT

VARIABLE PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
0	-	-	\$150,000.00
1 (\$1,041.00)	\$625.00 ³	\$416.00 ⁴	\$149,584.00
2 (\$1,039.27)	\$623.27	\$416.00	\$149,168.00
3 (\$1,037.53)	\$621.53	\$416.00	\$148,752.00
4 (\$1,023.40)	\$607.40	\$416.00	\$148,336.00

³Assuming an interest rate starting at 5% and decreasing every three months by .01%.

⁴Assuming a fixed contribution to pay off the loan amount in 30 years.



MODULE 5



VARIABLE PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
5 (\$1,021.71)	\$605.71	\$416.00	\$147,920.00
6 (\$1,020.01)	\$604.01	\$416.00	\$147,504.00
7 (\$1,006.02)	\$590.02	\$416.00	\$147,088.00
8 (\$1,004.35)	\$588.35	\$416.00	\$146,672.00
9 (\$1,002.69)	\$586.69	\$416.00	\$146,256.00
10 (\$988.84)	\$572.84	\$416.00	\$145,840.00
11 (\$987.21)	\$571.21	\$416.00	\$145,424.00
12 (\$985.58)	\$569.58	\$416.00	\$145,008.00

Total Annual Paid:	\$12,157.59
Total Interest Cost:	\$7,165.59
Total Principal Paid:	\$4,576.00
Outstanding Principal Owing:	\$145,008.00

FIXED PAYMENT

FIXED PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
0	-	-	\$150,000.00
1 (\$1,041.00)	\$625.00 ⁵	\$416.00	\$149,584.00
2 (\$1,041.00)	\$623.27	\$417.73	\$149,166.27
3 (\$1,041.00)	\$621.53	\$419.47	\$148,746.80
4 (\$1,041.00)	\$607.40	\$433.60	\$148,313.20

⁵Assuming an interest rate starting at 5% and decreasing every three months by .01%.



FIXED PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
5 (\$1,041.00)	\$605.71	\$435.29	\$147,877.91
6 (\$1,041.00)	\$604.01	\$436.99	\$147,440.92
7 (\$1,041.00)	\$590.02	\$450.98	\$146,989.93
8 (\$1,041.00)	\$588.35	\$452.65	\$146,537.28
9 (\$1,041.00)	\$586.69	\$454.31	\$146,082.97
10 (\$1,041.00)	\$572.84	\$468.16	\$145,614.81
11 (\$1,041.00)	\$571.21	\$469.79	\$145,145.01
12 (\$1,041.00)	\$569.58	\$471.42	\$144,673.59

Total Annual Paid:	\$12,492.00
Total Interest Cost:	\$7,165.59
Total Principal Paid:	\$5,326.41
Outstanding Principal Owing:	\$144,673.59

MONTHLY, SEMI-MONTHLY, BIWEEKLY OR WEEKLY MORTGAGE PAYMENTS

Mortgage payments are normally calculated with a monthly payment; however, many lenders now allow borrowers to pay more frequently. The advantage generally is the more often you pay, the less interest overall you pay. In fact, depending on how the payment is calculated, a payment every two weeks will act as one extra payment a year and reduce the overall debt quicker. Many people will choose their payment frequency to match up with their pay from work or to pay off the mortgage as quickly as possible. There is no right way.



NO INTEREST MORTGAGE

Although unusual for lenders to charge no interest, it is most commonly seen when a parent lends a child money to purchase a house. In Japan, the rate of interest is presently often quoted to be 0%. Under Sharia Law (a body of Islamic Law), lenders are not allowed for religious purposes to charge interest. Loans are often prepared with no interest payment although there is usually a sum paid as consideration for the loan.

VARIABLE PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
0	-	-	\$150,000.00
1 (\$416.00)	\$0.00	\$416.00 ⁶	\$149,584.00
2 (\$416.00)	\$0.00	\$416.00	\$149,168.00
3 (\$416.00)	\$0.00	\$416.00	\$148,752.00
4 (\$416.00)	\$0.00	\$416.00	\$148,336.00
5 (\$416.00)	\$0.00	\$416.00	\$147,920.00
6 (\$416.00)	\$0.00	\$416.00	\$147,504.00
7 (\$416.00)	\$0.00	\$416.00	\$147,088.00
8 (\$416.00)	\$0.00	\$416.00	\$146,672.00
9 (\$416.00)	\$0.00	\$416.00	\$146,256.00
10 (\$416.00)	\$0.00	\$416.00	\$145,840.00
11 (\$416.00)	\$0.00	\$416.00	\$145,424.00
12 (\$416.00)	\$0.00	\$416.00	\$145,008.00

Total Annual Paid:	\$4,992.00
Total Interest Cost:	\$0.00
Total Principal Paid:	\$4,992.00
Outstanding Principal Owing:	\$145,008.00

⁶Assuming a fixed contribution to pay off the loan amount in 30 years.



Discussion

1. What are the advantages or disadvantages of each payment method?
2. What circumstances would lead you to choose one payment method over another?

MORTGAGE MATH

In addition to Mortgage No. 1 outlined above, Martin and Cindy decide to consider a mortgage with the following terms (i.e., Mortgage No. 2):

MORTGAGE NO. 2:

Mortgage Principal Amount	\$150,000
Term	5 years
Number of Payments/Payment Frequency	60/Monthly
Interest rate	3.0%
Amortization Period	25 years (300 payments)
Monthly Mortgage Payment	\$709.87

- **Note** – 3% is the **annual** interest rate. However, mortgage lenders charge interest on the basis of the corresponding **monthly** interest rate amount. Monthly Interest Rate = 0.0025% per month (3% = 0.03 per year divided by 12 months)
- **Calculations** – To create an amortization schedule, multiply the principal balance by the monthly interest rate to get the monthly interest cost; subtract the monthly interest cost from each monthly payment to determine how much principal will be paid off each month, and then subtract the monthly principal amount from the previous principal balance to determine the new principal balance for the next payment period. That is:
 - Principal Balance * Monthly Interest Rate = Monthly Interest Cost
 - Monthly Payment – Monthly Interest Cost = How Much Principal is Paid Each Month
 - Previous Principal Balance – Monthly Principle Amount = New Principal Balance

**1. Calculate the following:**

- How much Martin and Cindy will spend on mortgage payments in the first year.
- How much of this amount will go to pay off interest.
- How much will go to pay down principal.
- How much Martin and Cindy will owe to the bank after making a year of mortgage payments.
- As a percentage, how much of their annual payments will go to pay off interest/pay down principal.

PAYMENT	INTEREST	PRINCIPAL	PRINCIPAL BALANCE
0	-	-	\$150,000.00
1 (\$709.87)	\$375.00	\$334.87	\$149,665.13...
2			
3			
4			
5			
6			
7			
8			
9			
10			
11			
12			



Total Annual Paid:	
Total Interest Cost:	
Total Principal Paid:	
Outstanding Principal Owing:	
Total Interest Cost as Percentage of Total Annual Paid:	
Total Principal Paid Off as Percentage of Total Annual Paid:	

2. In what ways are the terms of Mortgage No. 2 different from Mortgage No. 1? What might be the reasons for this difference?

3. Compare and contrast Mortgage No. 2 and Mortgage No. 1. Which mortgage is the better deal for the borrower? In what way(s) is it a better deal?



MOCK MORTGAGE NEGOTIATION

CONFIDENTIAL INSTRUCTIONS FOR MORTGAGOR (“BORROWER”)

You will work in pairs to complete a mock negotiation of a mortgage agreement for the purchase of a home. One student will play the role of the mortgagor and the other will play the role of the mortgagee. Review the facts below. Before beginning the negotiation, take time to develop your negotiation strategy and tactics and record the details in the *Negotiation Plan*. Complete all portions of the *Negotiation Plan* with the exception of the section on the final agreement. You may want to refer to the *Introduction to Negotiation* handout from Module 2. When both parties are ready, begin the negotiation. The goal is to finalize the terms of your mortgage agreement and record the details in the Mortgage Agreement, including completing the payment plan for a one-year term.

FACTS

- Purchase price is \$250,000.00.
- You have paid a \$5,000.00 deposit to the seller in the agreement of purchase and sale.
- You have a further \$20,000.00 to apply towards the purchase price of the home.
- The bank's posted interest rate is 5.0%. You have heard that banks will accept to lend at a discount of up to .75%.
- You want the longest amortization period available and a term of 5 years.
- You want the right to make pre-payments of at least 5% per year.
- You are scheduled to buy your home 45 days from today.
- You want the right to make semi-monthly payments, which coincides with your payroll deposits.
- You have been a client of the bank for the last 15 years, having taken various loans for cars and other significant purchases and always paid on time and in full.



CONFIDENTIAL INSTRUCTIONS FOR MORTGAGEE (“LENDER”)

You will work in pairs to complete a mock negotiation of a mortgage agreement for the purchase of a home. One student will play the role of the mortgagor and the other will play the role of the mortgagee. Review the facts below. Before beginning the negotiation, take time to develop your negotiation strategy and tactics and record the details in the *Negotiation Plan*. Complete all portions of the *Negotiation Plan* with the exception of the section on the final agreement. You may want to refer to the *Introduction to Negotiation* handout from Module 2. When both parties are ready, begin the negotiation. The goal is to finalize the terms of your mortgage agreement and record the details in the *Mortgage Agreement*, including completing the payment plan for a one-year term.

FACTS

- Purchase price is \$250,000.00.
- The Borrower has paid a \$5,000.00 deposit to the seller in the agreement of purchase and sale.
- The Borrower has a further \$20,000.00 to apply towards the purchase price of the home.
- The bank's posted interest rate is 5.0%. You are prepared to offer a discount of up to 1.0% for good clients.
- The bank has no preference regarding the amortization period, term of the mortgage, or payment schedule, however it is limited to issue mortgage with a maximum amortization of 30 years and offers terms of 6 months, 1, 2, 3, 5, 7 and 10 years.
- The bank offers the right to pre-payment up to 10% per year.
- The Borrower is scheduled to buy the home 45 days from today.
- The Borrower has been a client of the bank for the last 15 years, having taken various loans for cars and other significant purchases and always paid on time and in full.
- The loan amount and other credit scores are within the tolerances of the bank for similar mortgages.



NEGOTIATION TIMELINE*

Preparing for the Negotiation		
Develop Your Negotiation Plan	Each student (borrower and lender) individually complete their <i>Negotiation Plan</i> .	10 mins
Borrower & Lender Negotiation		
Step 1	The borrower and lender should set out the issues to be discussed and negotiated.	5 mins
Step 2	The borrower and lender meet to discuss the availability and details of a possible mortgage loan. The students negotiate the terms under which they will agree to lend/borrow the funds. During this stage, generate settlement proposals that satisfy the interests of both parties. Agree to the identified issues individually or as a package.	20 mins
Step 3	Put the agreed points for the mortgage into the <i>Mortgage Agreement</i> for the parties to sign. Typically the lender offers the loan at the terms to be agreed to and the borrower accepts if they are satisfied with the loan details. Have the lender sign to offer the loan and the borrower sign to accept the term sheet.	5 mins
Debrief		
Class Discussion	Debrief with the whole class by comparing the results of the negotiations. There will be many different results which will help highlight that there is no right answer to a negotiation but rather the answer is an agreement by the parties' negotiation which satisfies them.	15 mins

*Times are approximate/suggested. Sometimes the negotiation process can lead to an agreement at the first meeting, but often this meeting lasts several hours or longer. Depending on the complexity of the case, it can also take many meetings before an agreement is reached.



NEGOTIATION PLAN

OBJECTIVES/ISSUES:

OVERALL STRATEGY:

TACTICS AND TECHNIQUES:

OFFERS:

Opening Offer	Target	Bottom Line

FINAL NEGOTIATION AGREEMENT:



MORTGAGE AGREEMENT

Mortgage Principal Amount	
Term	
Number of Payments/Payment Frequency	
Interest rate	
Monthly Interest Rate	
Amortization Period	
Monthly Mortgage Payment	
Prepayment Privilege	

Signature, Borrower

Signature, Lender

