The High Costs of High Ratio Mortgages

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The low interest era that Canadians have enjoyed for the past few years has made homeownership accessible and affordable for many people. It has also resulted in a substantial number of home buyers entering the market without paying a large deposit on their dream home.

Any home buyer with a deposit of less than 20% of the purchase price of their home is taking out a high ratio mortgage. In Alberta, these high ratio mortgages come with significant costs for the buyer and increased power for the financial institution. Before taking out a high ratio mortgage, home buyers should make themselves aware of the drawbacks of these mortgages and be comfortable with the potential scenarios that could come into play should they wish to, or be forced to, sell the property before the mortgage is repaid.

What are the Differences Between a Conventional and a High Ratio Mortgage?

The first significant difference between a conventional and high ratio mortgage is default insurance. Homeowners purchasing a property with a deposit of less than 20% and obtaining a mortgage from a regulated lender are required by law to take out insurance against their potential default on the mortgage. The cost of this insurance is typically 2-3.5% of the loan amount. It is included as a one-off payment at the time of the mortgage advance and the cost is added to the total mortgage loan obtained from the financial institution.

While the idea of taking out insurance may sound comforting to a home buyer the insurance coverage provided is only for the benefit of the financial institution; the home buyer simply pays for it on the financial institution’s behalf. The insurance policy does not provide any protection for the home buyer. Should a home buyer default on the mortgage the financial institution may foreclose and take title to the property. If the financial institution is unable to recoup its full loan amount when it resells the property, then the financial institution will obtain judgment against the homeowner for the deficiency and turn to the insurance policy to make up the shortfall.

The second major difference between high ratio and conventional mortgages is the obligation the home buyer has and is required to provide on the loan. With conventional mortgages, only the mortgaged property is used as security. If someone with a conventional mortgage defaults on the mortgage, all their other personal assets are safe. But, with a high ratio mortgage, the buyer may be required to repay the shortfall amount that the insurer pays to the financial institution personally from any assets they have. Should a financial institution turn to an insurer to recoup the full value of the loan, then the insurer may pursue whatever assets the buyer has(for info these are now exempt – a matter of public policy) , until they have recouped their payout.

The Potential Risks Involved with a High Ratio Mortgage

One of the great and unexpected dangers buyers face when they take out a high ratio mortgage is stagnant or declining property values. If the buyers find themselves in a position that they must sell the house, and the value of the property is the same or lower than when they took out the mortgage, the buyer may have a shortfall in funds needed to repay the mortgage. This is due not only to a lower selling price, but also to the high costs associated with selling a home. Most mortgages come with early repayment penalties if they are being paid out in full prior to the expiry of the term of the mortgage. Combine that with real estate broker fees and the cost of selling a home can easily mount to $30,000 or more.

Sellers might think that one option for avoiding the early repayment fees is to sell the property and assign the mortgage to the new owner. This may be appealing to a new buyer as interest rates are on an upward trend, making the old mortgage terms a bargain. But beware. The original buyer who obtained the mortgage is still liable for the loan even if it has been transferred to a new owner. Should the new owner default before the mortgage is paid in full, then both parties will be pursued to make up the funds.

The long reach of the financial institution applies to spouses who are legally separated too. A formal separation agreement between spouses, in which one agrees to take over the property and the mortgage, does not remove the liability for the high ratio mortgage from the other spouse. Anyone separating from a spouse should seek a formal release from the lender to avoid being on the hook for the mortgage at a later date.

Additional Responsibilities Associated with a High Ratio Mortgage

Beyond the repayment terms and the level of liability should those repayments fall into arrears, home buyers should be aware of the other obligations they are committing to when they sign the mortgage contract. These include:

- to insure the property;
- to pay property taxes; and
- to keep the property in good repair.

It is also worth noting that if a buyer falls into arrears on the mortgage but is able to make up the shortfall, they will also be required to repay any expenses incurred by the financial institution in their efforts to have the loan repaid. These sums can be significant.

Anyone considering taking out a high ratio mortgage should carefully weigh the pros and cons. While they may give people an opportunity to own a home that they might not otherwise, there are short-term and potential long-term costs. Home owners currently committed to a high ratio mortgage must also carefully weigh their options if selling the house becomes necessary.

The real estate lawyers at Duncan Craig LLP are here to advise you on your options, protect your long-term interests and assist with your home purchase and sale. Please contact us if you have any questions.

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