Financial Consumer Agency of Canada
Agence de la consommation en matière financière du Canada

ABCs OF MORTGAGES SERIES

BORROWING ON HOME EQUITY

Smart mortgage decisions start here

Financial Consumer Agency of Canada
IT PAYS TO KNOW.

Canada

TABLE OF CONTENTS

About Financial Consumer Agency of Canada (FCAC)

With educational materials and interactive tools, the Financial Consumer Agency of Canada (FCAC) provides objective information about financial products and services to help Canadians increase their financial knowledge and confidence in managing their personal finances. FCAC informs consumers about their rights and responsibilities when dealing with banks and federally regulated trust, loan and insurance companies. FCAC also makes sure that federally regulated financial institutions, payment card network operators and external complaints bodies comply with legislation and industry commitments intended to protect consumers.

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OVERVIEW

If you need extra money for projects such as a home renovation, or if you want to consolidate debts that have higher interest rates, one solution is to borrow using your home equity as security.

Your home equity is the difference between the value of your home and the unpaid balance of any current mortgage. Your home equity increases with time as you pay your mortgage down and as the value of your home increases.

If you are looking for a loan, you will often be offered a better interest rate if the loan is secured by your home equity.

Not all financial institutions offer home equity financing options as described in this section. Check with your financial institution about the financing options that it offers.

WHAT ARE THE DIFFERENT OPTIONS?

The four most common ways of using your home equity to get extra financing before the end of your current term are:

- refinancing
- borrowing any amount you prepaid on your mortgage
- obtaining a home equity line of credit
- taking out a second mortgage.

The benefit of using one of these options rather than another kind of loan, such as a personal loan or a credit card, is that interest rates on loans secured with home equity can be much lower.

Remember:

- You must qualify for these home equity borrowing options.
- Don't borrow more than you can afford. **If you are unable to repay the amounts you have borrowed, plus interest, you could lose your home.**

1. REFINANCING

Some mortgage lenders offer their customers refinancing options. This allows home owners to access the equity they have built up over time. Refinancing may involve changing the terms of your original mortgage agreement, and the refinanced portion may have a different interest rate than the original mortgage. You may have to pay fees in order to do this.

You can usually borrow up to 80% of the appraised value of your home, minus the amount left to pay on your first mortgage. If you borrow over 80% of the appraised value of your home, you will have to pay mortgage default insurance premiums.

EXAMPLE:

Louise is planning a home renovation project and is looking at refinancing her home to fund the renovation. Her house is currently worth $200,000 on the real estate market, and she still has $100,000 left to pay on her mortgage. Her mortgage lender calculates her credit limit for refinancing as follows:

Appraised value of home:	$200,000
Maximum loan allowed:	x 80%
Loan amount based on appraised value:	= $160,000
Less balance owed on mortgage:	– $100,000
Refinancing credit limit:	**$60,000**

If the lender and Louise agree to refinance her home to the $60,000 limit, she would owe a total of $160,000 on her mortgage.

2. BORROWING AMOUNTS YOU PREPAID

Some lenders offer their customers prepayment options that help them to pay their mortgages off faster, such as making lump-sum payments.

If you have made prepayments, your lender may allow you to re-borrow the amount you have prepaid on your mortgage. **These newly borrowed funds will be added to the balance of your mortgage principal. The interest rate may be different from the rest of your mortgage for the remaining term.**

EXAMPLE:

- Allan's original mortgage payment schedule showed that he would have $100,000 left in principal to pay on his mortgage after making payments for three years.
- During those three years, Allan also prepaid $20,000 against his mortgage, leaving him with $80,000 ($100,000 – $20,000) in principal to pay off.
- Allan wants to do home renovations that will cost $10,000.
- His financial institution allows him to borrow $10,000 from his prepaid amount without having to make any changes to his mortgage term.
- After borrowing the money, Allan's outstanding mortgage principal is $90,000 ($80,000 + $10,000).

3. HOME EQUITY LINES OF CREDIT

A home equity line of credit (HELOC) works much like a regular line of credit. You can borrow money whenever you want, up to the credit limit. You can pay it back and borrow again. You have to apply for a HELOC to find out whether you qualify.

The Office of the Superintendent of Financial Institutions (OSFI) has issued guidelines for federally regulated lenders, such as banks, that address the maximum amount for a HELOC. OSFI expects federally regulated lenders to limit new HELOCs to **65%** of your home's appraised value. A HELOC can be combined with a regular mortgage for a maximum of 80% of your home's appraised value.

EXAMPLE:

- Nicole would like to get a HELOC to use for a home renovation.
- Her house is currently worth \$200,000 on the real estate market, and she still has \$100,000 left to pay on her mortgage.
- Her mortgage lender calculates her HELOC limit as follows:

Appraised value of home:	\$200,000
Potential maximum for HELOC and regular mortgage combined, based on appraised value (maximum 80%):	= \$160,000
Less balance owed on mortgage:	– \$100,000
Maximum credit limit on HELOC:	**\$60,000**

Note: As Nicole pays off more of her mortgage, she will be able to borrow additional funds with her HELOC, up to a maximum of \$130,000 (or 65% of her home's appraised value of \$200,000).

4. SECOND MORTGAGES

A second mortgage is a second loan that you take and secure with your home equity, in addition to your original mortgage, with a different mortgage lender. While making payments on your second mortgage, you also continue to make the payments on the original mortgage.

The term "second" indicates that a second loan is registered against your home in addition to the first mortgage. If the loan goes into default – that is, if you cannot continue to make your payments and your home is sold to pay off the mortgage – your original mortgage lender has priority and would be paid before any funds go toward the second mortgage lender. Therefore, a second mortgage is riskier for mortgage lenders. **This is why interest rates on second mortgages are usually higher than on first mortgages.**

You can usually borrow up to 90% of the appraised value of your home, minus the amount left to pay on your first mortgage. If you borrow over 80% of the appraised value of your home, you will have to pay mortgage default insurance premiums.

COMPARING YOUR OPTIONS

To decide which type of loan best suits your needs, compare features such as the credit limit, the annual interest rate, how you would access the money, the payments you'll have to make and other fees that could apply.

The following table summarizes the costs and features of the four options. All of the following options have interest rates that are lower than the rates that credit cards and personal loans offer.

	Refinancing	Borrowing prepaid amounts	Home equity line of credit	Second mortgage
Interest rates	Fixed or variable May result in a change to the existing interest rate on your mortgage, or a different rate for the refinanced portion	May be a blended interest rate or the same interest rate as existing mortgage rate	Variable: will change as market interest rates go up or down	Fixed or variable, generally higher than on first mortgage
Credit limit	**80%** of your home's appraised value, minus the unpaid balance of the existing mortgage	Total of amounts prepaid	**65%** of your home's appraised value	**90%** of your home's appraised value, minus the unpaid balance of the existing mortgage
Access to money	One lump sum deposited to your bank account	One lump sum deposited to your bank account	As needed, using regular banking methods	One lump sum deposited to your bank account
Fees	May have adminis-trative fees, such as appraisal fee, title search or title insurance, and legal fees	Varies between lenders	Administrative fees, such as appraisal fee, title search or title insurance, and legal fees May include the following fees: • maintenance • transaction • inactivity	Administrative fees, such as appraisal fee, title search or title insurance, and legal fees

ABOUT THE *ABCs OF MORTGAGES* SERIES

The *ABCs of Mortgages* series explains the features and costs of mortgages. The following resources are part of the series and are available on FCAC's website at **www.fcac.gc.ca**:

Publications

- Buying Your First Home
- Paying Off Your Mortgage Faster
- Renewing and Renegotiating Your Mortgage
- Borrowing on Home Equity

Tip sheets

- Shopping Around for a Mortgage
- Buying and Maintaining a Home: Planning Your Housing Budget
- Choosing an Amortization Period: What is the Impact on Your Mortgage
- Understanding Variable Interest Rate Mortgages
- Understanding Reverse Mortgages
- Protect Yourself from Real Estate Fraud

Online tools

- Mortgage Qualifier Tool
- Mortgage Calculator Tool

Online Quiz

- Mortgage Quiz

GLOSSARY

Amortization period
The period of time it will take to pay off a mortgage in full. The most common amortization period for a new mortgage is 25 years. Not to be confused with the **term** of the mortgage.

Home equity
The difference between the value of your home and the unpaid balance of your mortgage. Your home equity increases with time as you pay your mortgage down and/or as the value of your home increases.

Mortgage default insurance
Insurance that protects the mortgage lender if you cannot make your mortgage payments. It is required by law if your down payment is less than 20%. This should not be confused with mortgage life insurance or home, property, fire and casualty insurance, which typically protect the home owner.

Prepayment
Payment of an additional portion or all of the principal balance before the end of your term. Lenders may charge fees when you use a prepayment option under a closed mortgage agreement.

Principal
The amount of money that you borrowed from a lender to pay for your home.

Second mortgage
An additional mortgage that is taken out on the same property while you continue to have a first mortgage. You continue to make the payment on the original mortgage as well as the payment on your second mortgage.

Term
The period of time your mortgage agreement will be in effect. At the end of the term, you either pay off the mortgage in full, renew it or possibly renegotiate your mortgage agreement (for example, decrease your amortization period). Terms are generally for six months to 10 years. Not to be confused with the **amortization period**.