Terms and Conditions of Mortgages

Not only will you have to choose a type of mortgage, you will also have to choose various terms and conditions. Some terms and conditions that you will find associated with mortgages are:

First mortgage - This is the portion of the total debt registered against your property that is secured by first call on the property. In simpler words, if you default, the holder of the first mortgage has first call on the value of the property in order to recover the loan.

Second mortgage - This is the portion that comes second in line. The interest rate is usually higher to reflect the increased risk to the lender.

Open mortgage - This mortgage allows the borrower to repay the loan more quickly than agreed. Repayment can be done on anniversary dates or regular payment dates, with or without prepayment charges.

Closed mortgage - This mortgage is one that does not allow the borrower to repay the loan more quickly than agreed. Payments must be made as specified in the agreement. If extra payments are allowed that the lender has the right to levy a prepayment charge and this may be specified in the original mortgage agreement.

Fixed-rate mortgage - This is a mortgage where the rate of interest has been set for a specific period of time that is also known as the term of the mortgage. This may be for as much as five years or as little as six months. The monthly payment of principal and interest remains the same throughout the term.

Variable-term mortgage - This is a mortgage where the rate of interest changes from time to time as money market conditions change but is usually not changed more frequently than once a month. It was developed in order to provide maximum flexibility to borrowers in times of volatile or changing interest rates. The monthly payment does not change. The difference lies in the way that the monthly payment is applied…

- **If interest rates go up** then more of the monthly payment must be applied toward interest. If interest rates rise dramatically then the monthly payment may not cover all of the interest leaving you with interest still owing. This owed interest will then be added to the principal still owed and can result in erosion of your equity in the house**. ***
- **If interest rates go down** then more of the monthly payment will be applied to the principal.

***Equity** is the difference between the amount for which the property could be sold and you still own on the loan. If the equity is eroded, the mortgagee or lender may require the borrower to increase the monthly payment, repay additional principal, pay for an update appraisal, and/or repay the loan in full. Another alternative might be to convert to a fixed-rate mortgage and might be an option that you might wish to discuss with the lender.

Leasehold mortgage - This is a mortgage on a home and/or improvements where the land is rented rather than owned. These mortgages must be amortized over a period that is shorter than the length of the land lease.

Other forms of mortgages may periodically be offered by the government, lenders and vendors and these should be looked into very carefully. In June 1984 the House of Commons passed a mortgage rate protection program which enables some homeowners to purchase insurance to partially protect their monthly payment against substantial increases in mortgage rates. Details of this program should be looked into when negotiating a mortgage.