Homebuyers Blinded by Low Mortgage Rates Are Making These 3 Costly Errors

Description

For the last year and a half, low mortgage rates have prompted many Canadians to rush into the housing market and find a home. And why shouldn't they? After all, the lower your mortgage rate, the lower your overall mortgage payments, right?

Well, not necessarily. While mortgage rates play a big role in how much you ultimately pay for your home, they're only one among numerous mortgage costs. Mortgages are big, complex beasts, and if you look at only the rate, you could make some pretty costly errors. In particular, here are three costs that are all too easy to overlook.

1. Mortgage default insurance

With home prices still extremely high, most Canadians can't afford a 20% down payment on a house. That means many Canadians will have to pay for mortgage default insurance (also known as CMHC insurance).

Mortgage default insurance protects your lender in the event that you no longer make mortgage payments, resulting in a default. It could be as low as 2.8% and as high as 4% of your mortgage amount. Depending on how much mortgage you're borrowing, as well as the size of your down payment, that can get expensive fast.

To show how expensive this can get, let's say you put 10% down on a $750,000 house, or a $75,000 down payment. If your lender slaps a 3.10% charge for mortgage insurance, you'd pay a total of $20,925 *just* in insurance.

The more down payment you have, the less you'll pay in mortgage default insurance, and with 20%, you'll avoid it all together. Consider that before you lock into a historically low rate with only 8% of the total purchase price in cash.

2. Penalties

Before you sign your mortgage, be sure you understand your prepayment options and the penalties for breaking your mortgage agreement.

Prepayment terms are notoriously rigid. Typically, your lender will allow you to increase your mortgage payment by a certain amount every month or year. Go over that agreed upon amount, however, and you could get slapped with a penalty. The prepayment options will vary from lender to lender, so you'll want to pay extra close attention to your mortgage's terms.

Breaking your mortgage agreement will also result in a penalty. For instance, if you want to move out of your house sooner than your mortgage allows, you might pay an exit fee. The same goes for refinancing your mortgage: some lenders won't let you refinance, not even for a penalty.

3. Closing costs

Finally, along with the mortgage, be sure you budget for closing costs. For instance, you'll have to pay for a home inspection (unless you skip it, which I don't recommend). You'll also pay a land-transfer tax and legal fees to a real estate lawyer who will then prepare official documents for you.

Bottom line

Don't get me wrong: a historically low interest rate can result in lower monthly mortgage payments. But that doesn't mean you should rush into a house right now. If your down payment is fairly small, if you haven't budgeted out the closing costs, you might be better off waiting until you have more money saved.

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