3 Mortgage Mistakes Every First-Time Homebuyer Makes (And How to Avoid Them)

Description

With the Bank of Canada warning us that mortgages will go up in 2022, first-time homebuyers are surely feeling the pressure to rush through the home-buying process and sign the dotted line on their first home — before their mortgage payments can get more expensive.

But let's face it: mortgages can be fairly complicated, and if you're blinded by low rates, you could make some pretty costly errors. Here are three common mistakes that you should avoid at all costs.

1. Assuming you can afford your pre-approval amount

When you get a mortgage pre-approval, your mortgage lender will assess your income and debt, then give you a mortgage amount and estimated monthly payment that *they* think you can afford.

But that's the trick — it's just what they think. And it might be much higher than what you can actually afford.

Your lender won't ask you how much you're paying for groceries, for instance, nor what you pay in childcare, transportation, or your other monthly expenses. They typically have no idea what your budget looks like, which means they might approve you for an amount that's beyond your budget's scope.

First-time homebuyers often take the bait and buy homes they can't afford. But if you're savvy, you'll look past the pre-approval amount and base your home-buying decision on your budget alone.

To decide how much of your income you can reasonably allocate to monthly mortgage payments, try the 28/36 rule. That is, your mortgage payment shouldn't be more than 28% of your total monthly pre-tax income nor more than 36% of your total debts. If you stay within these guidelines — ignoring the upper limits on your pre-approval — you'll have a better understanding of how much you can afford.

2. Overlooking contract details

Oh, this is a bad one — rushing through your mortgage contract.

To be fair, no one actually *likes* reading mortgage contracts. In the ranking of boring things to read, mortgage contracts are just below credit card contracts — and right above *Moby Dick.*

But this isn't the time to snooze off to a boring read. Your mortgage contract will help you understand your prepayment options. That is, if you go over your mortgage payment by a certain amount, 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 could also result in a penalty. For example, 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. Forgetting the cost of mortgage default insurance

Finally, if you can't afford a 20% down payment on a home, you'll pay mortgage default insurance (also known as CMHC insurance).

As the name suggests, mortgage default insurance protects your lender if you default on your mortgage. The charge could be as low as 2.8% or 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.

Now, of course, the more down payment you have, the less you'll pay in CMHC insurance. With a full 20% down payment, you'll avoid it all together. Consider that before you lock into a historically low rate with only 5% of the total purchase price in cash.

Foolish bottom line

Before you rush into your mortgage, be sure you understand what you're buying. Read through your contract, and understand the penalties associated with your mortgage product. Factor in the cost of CMHC insurance, and don't assume your mortgage pre-approval amount is an amount you can actually afford.

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