Tangerine guides to personal finance

Taking possession

What to watch for when buying your first home

Tangerine
Forward Banking

“Buyers are often surprised that newly-built homes might need additional work too…”

Like no other purchase

You've talked, planned, and saved, and now you're ready to buy your first home. It's likely that no other purchase in your entire life is going to be as exciting – or as financially important – as this one will be. Buying a house or condominium can be the fulfillment of a dream, but it can be complicated too. The real estate market is messy, there are a lot of steps in the home buying process, and you're likely to face some high-stakes, high-pressure decisions. Plus it's not all a matter of logic: every home is different, your needs and wants are very personal, and both buyers and sellers may become emotional from time to time.

Given all that, it's good to be aware of some common potential pitfalls – and the myths and misperceptions that make them hard to spot. After all, the more you know, the better equipped you'll be to follow through on strategies that will work for you, to be prepared for expenses you'll encounter along the way, and to make informed (and better) decisions.

“Okay, I’ve saved up a down payment and my mortgage payments will be similar to my rent. I’m ready to be a home owner.”

#1 Ownership means the buck stops with you

Being ready for home ownership is not just about the mortgage payments. For example, like any other building a home requires regular maintenance — but while a renter can expect the landlord to make essential fixes, an owner is the landlord. Unless you have the money to hire other people to shovel the walk, replace the furnace filter, or clean the dryer vent, you’ll be doing the work. So be prepared to spend significantly more of your time and cash on attending to necessary household tasks. You may also need to learn a few new skills — you never know when you’ll have to fix a leaky faucet or repair tile grout. And you may find yourself at the hardware store a lot more often!

Of course, with responsibility also comes the benefit of control. If you want to paint your living room wall bright purple, add built-in cabinets, or install a better dishwasher you can go right ahead and do it — it’s your place!*

** Major changes may require building permits from your municipality. You’re not in complete control.*

"Our mortgage specialist says we're preapproved for up to a certain amount, so it's fine if we're looking at homes listed near the top of that range."

#2 Remember to leave room for additional costs

Having a pre-approved mortgage in hand will often raise your expectations about the kind of home you plan to buy. But beware of buying too close to that limit, since you'll also need to budget for closing costs like legal fees, land transfer taxes, and (optionally) title insurance. Then you should factor in the costs involved in moving, any renovations you're going to need to do from the start, and the price of any appliances, furniture, and decorations you'll need to buy. Even small costs for set-up tasks like changing the locks can add up. As a homeowner you'll also have additional bills to pay — such as property taxes, utilities, and ongoing maintenance. Estimate your monthly carrying costs as a whole (mortgage payments based on your intended offer, property taxes, condo fees, maintenance, and so on), and make sure you can afford the total before you make an offer.

“Okay, we’ve taken all those costs into account, and we know we can afford the house we want.”

#3 Over the long term you might be able to afford less than you think

In addition to the bills and expenses discussed above, your lifestyle choices will have a big impact on what you can afford. The overall financial picture your mortgage is based on will not take into account your plans to travel over the next year, your financial obligations to your family, or the amount you spend on your favourite hobby. When a home and its costs are factored in, you might find yourself unable to afford that monthly golf game or annual ski trip you’re used to enjoying. Before you submit an offer, make sure you can live with that.

And since the affordability of your mortgage depends on your income, consider what might happen if your income were to drop due to a change in circumstances.

Remember too that if interest rates go up (as most experts are predicting will eventually be the case), your monthly mortgage payments will rise as well. With a variable rate mortgage, this happens quickly — often within a few months. With a fixed rate mortgage, you’ll face the possibility of a higher rate only at the end of your term.

Think about scenarios like these, and make sure the home you hope to buy will stay comfortably within your means if one of them were to occur.

“It’s move-in ready!
We won’t have to do a thing to it.”

#4 Work may be needed no matter whether it’s a new home or a resale

When you buy a resale home, unless there are changes listed specifically in the contract, you’re purchasing everything “as is.” You may find there are things you’d like to upgrade, and after you move in you may discover some surprises: unusual plumbing or wiring, for example, or unreliable appliances. Having a home inspection done in advance can help you plan for some of these expenses.

Buyers are often surprised that newly-built homes might need additional work too. Individual provinces and regions like Atlantic Canada have warranty programs ensuring that defects in work and materials, building code violations, and even major structural defects are fixed by builders in a timely manner if problems are discovered within a defined number of years after the owners have taken possession. But since problems may arise after a warranty period has expired, or the changes may not be covered under the warranty at all, it’s smart to have cash set aside to cover potential expenses.

“I’m not going to compromise on my dreams.”

#5 Too many “must haves” might paralyze you (or lead you to pay more than planned)

There are no perfect houses. The benefit of owning a home is you can make it your own, tailoring it to your needs and tastes — but the majority of the homes you’ll look at are very unlikely to offer everything on a lengthy list of “must haves”. Whether you’re buying a condo or a house, you’ll need to make tradeoffs between your needs and wants. One property may have the renovated kitchen you’re looking for, but another might be in a more desirable neighbourhood. Figure out what your top priorities are, what you can live without for now (and might potentially add or renovate later), and what you can be comfortable not having at all. Not only will this help you find a home you’ll be happy in, but it will also help keep you grounded financially – since adding more “dream” features also tends to add to the price.

“This place is going to be worth so much more in a few years when we decide to sell it.”

#6 Your principal residence is first and foremost a home

Diversification is one of the most fundamental of investing strategies, but in buying a home you’re effectively doing its opposite: putting the bulk of your wealth into a single asset, whose value — when you decide to sell it one day — may have risen or fallen for a variety of different reasons, many of them impossible to control.

You can’t avoid this risk if you want to own a home, of course, but that’s exactly why a property purchase that’s mainly about your desire to own and live in a home shouldn’t be considered primarily as an investment. If you live in a home that you love for ten years and then happen to sell it at a loss, you’ll still have generated an immeasurable amount of personal value. So unless you’re buying strictly for investment purposes, you probably don’t want to focus too much on trying to predict the future financial return on your home purchase.

"All I need to do is save a 5% down payment to get into the market."

#7 Saving more than the bare minimum is almost always worth the wait

You might be eager to buy a home as soon as you can, but remember that the smaller your down payment is, the greater your interest charges will be over the long run. Also, for down payments less than 25%, most lenders will require mortgage insurance, and you'll pay for this insurance via premiums on your total loan amount (in September 2014, for example, the premium on a 5% down payment was 3.15% of loan value*).

In deciding how much of a down payment to save and when to get into the market, you may want to consider what you're paying in rent, and how your monthly mortgage costs compare based on your expected down payment amount. If you're moving from an expensive apartment into an inexpensive home, it might make financial sense to make a smaller down payment and move sooner. Your economic stability and whether or not you have an emergency fund may also be important considerations.

Remember that as a first-time homebuyer you have the option of borrowing from your RSP under the Federal Government's Home Buyers' Plan** to help fund your down payment.

** For up-to-date insurance premiums, consult the Canada Mortgage and Housing Corporation (CMHC) table of rates: http://www.cmhc-schl.gc.ca/en/co/moloin/moloin_005.cfm*

*** More information about the Home Buyers' Plan is available on the CRA website: http://cra-arc.gc.ca*

Price of home: $500,000

25% Downpayment = $125,000	Saving for a full downpayment now will save you a lot of money in future	5% Downpayment = $25,000
Mortgage $375,000		Mortgage $489,962 ($475,000 + 3.15% Mortgage Insurance Premium)
Total interest paid $204,036	+ $62,550	Total interest paid $266,586
Monthly payment $1,930	+ $592	Monthly payment $2,522

Source: Tangerine's Mortgage Payment Calculator
http://www.tangerine.ca/en/calculators/calculators.html#mpc

Notes: The rate of interest used in the above calculations is 3.79% (the posted five-year rate in effect Nov. 5, 2014), along with a 25-year amortization

Worksheet: Price and property requirements

How much to pay	
Pre-approved mortgage amount	$
Would like to pay…	$
Will not pay a cent more than…	$

Must haves	Why?
1.	
2.	
3.	
4.	
5.	

Would like to have	
1.	9.
2.	10.
3.	11.
4.	12.
5.	13.
6.	14.
7.	15.
8.	16.

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About

This publication is part of Tangerine's series of guides for Canadians on important personal finance topics.

http://www.tangerine.ca/en/tools/index.html

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