PATCHING
MORTGAGE SERVICES

7 STEPS TO AN IDEAL MORTGAGE

@patchingmortgageservices

604.561.6716

daniel@citywidemortgage.ca

www.patchingmortgageservices.ca

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1.PAY OFF YOUR MORTGAGE FASTER

We all want to be debt free! But how can you get there with real estate prices continuing to increase, along with the basic cost of living? The simple answer is: Paying your mortgage faster. Included below are some simple, effective ways where smart “long-term” decisions can ultimately get you ahead faster. It won’t happen overnight, but you’ll be amazed at how making consistent choices will help you accomplish your mortgage goals.

INFLATION HEDGE STRATEGY

An Inflation Hedge Strategy can not only pay down your mortgage faster but it will also decrease your payment shock at the end of your mortgage term.

WHAT IS PAYMENT SHOCK?

Today mortgage rates are historically low, meaning an increase is inevitable in the months/years to come. When you acquire a mortgage at a historically low rate, you’ll need to brace yourself for the probability of an increase. As rates increase, so will your payments. This, simply put is ‘payment shock.’

HOW DO YOU DECREASE ‘PAYMENT SHOCK’ AND PREPARE FOR HIGHER FUTURE RATES?

As an example, let’s say you sign a new five-year term mortgage ($450,000 amortized over 30 years) at 3.14%. Five years later, when it’s time to renew, that rate now sits at 5.50%.

Year 1 – Payments are based on the rate of 3.14%.
Year 2 – Payments are increased to reflect the rate of 3.75%
Year 3 – Payments are increased to reflect the rate of 4.25%
Year 4 – Payments are increased to reflect the rate of 4.75%
Year 5 – Payments are increased to reflect the rate of 5.50%

If an Inflation Hedge Strategy is not used, the payment shock would be $521 per month and the mortgage balance at the end of the five-year term is decreased by $12,704. The overall amortization then decreases by 7 years and 4 months.

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By following the technique above, you will have accomplished the following:

1. Effectively managed your largest debt.
2. Accelerated your mortgage payment.
3. Increased your overall equity for if/when you decide to move.

LUMP SUM PAYMENTS:

Accelerated Bi-Weekly Payments: If you choose to make payments bi-weekly instead of once per month, you're making 26 payments over the course of a year as opposed to 12. This method is highly recommended if you're able to increase your bi-weekly payment amount.

***Note: Most (if not all) lenders will approve your decision to increase your payment amount the frequency of your payments.**

Let's now look at how accelerated bi-weekly payments can decrease your amortization and pay your mortgage down sooner.

Based on a mortgage of $500,000 with a 25-year amortization and a 5-year fixed rate of 2.59%, your bi-weekly payment amount would be #1043,54. After 5 years, your outstanding balance would be $423,593.

If you decide to amend your bi-weekly payments and accelerate them at the start of your term, your new payment would be $1131.50 (calculated by dividing your monthly payment in half). The result would lead to a decreased amortization of 2 years and 7 months and would leave a new balance of $411,805 remaining after your 5-year term. You're ahead by $12,148!

By paying your mortgage faster you're also positioning yourself to:

- Pay less interest.
- Increasing your equity in the event you decide to sell your home.
- Access that equity for other possibilities.
- Forced savings tool.
- A reduced cost of living.
- Peace of Mind!

If you do decide to accelerate/increase your payments, you can always revert back to your original payments. Most lenders will allow you to adjust without concern.

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2.HOW TO DECIDE BETWEEN A VARIABLE RATE MORTGAGE VS. A FIXED RATE MORTGAGE

In today's market (as of October, 2020) a 5-Year Term would secure you a low rate and would protect you against rate fluctuations for a manageable period of time. Think of it as an "Inflation Hedge Strategy."

An Important Point to Consider:

Do you want a Fixed Rate or Variable Rate Mortgage (VRM)?

Currently, a Variable Rate Mortgage is Prime less 0.50% (2.20%) and a 5-year Fixed Rate could be as low as 2.44%, which creates a potential difference of 0.24%.

If we compare a 5-Year Fixed rate of 2.44% to a 5-Year Variable Rate Mortgage at PRIME less 0.50%, the result works out to be similar after 5 years and the 0.24% difference. **NOTE: This does not account for any changes to the Prime Rate within the next 5 years.** If the Prime Rate goes up, then a Fixed Rate would be the better play. One year ago, the spread was a difference of 0.70%, so a Variable Rate Mortgage would have been recommended.

Today I would recommend a Fixed Rate Mortgage.

Some other things to consider if you decide on a Variable Rate Mortgage instead of a Fixed Rate Mortgage:

MARKETING TRENDS

- What is the Bank Of Canada's current Prime Rate?
- What current/recent trends could impact the Prime Rate positively or negatively?

ARM (ADJUSTABLE RATE MORTGAGE) VS. VRM (VARIABLE RATE MORTGAGE)

ARM – Your payment amount changes when the Prime Rate changes, but your current remaining amortization does not change.

VRM – Your payments remain constant, but if the Prime Rate changes, your amortization increases. This means that more of your monthly payment goes towards interest and not the principal. Paying off your mortgage will ultimately take longer under these circumstances.

CONVERTING TO A FIXED TERM FROM A VRM

It is important to note that some lenders will negotiate a "Lock-In" rate, while others are more prone to providing a firm/competitive 'discounted rate" which removes the stress of negotiation.

MONITOR RATE AND MARKET TRENDS

When you have a Variable Rate Mortgage, it will be important to monitor the market trends. Part of my job is to keep you in the loop as the trends change (or stay the same).

I can assure you that my job as your mortgage broker does not end once the papers are signed. If anything this is only the beginning of a productive, successful relationship together.

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3.HOW TO FIND THE BEST POSSIBLE MORTGAGE RATE

Before we find you the best mortgage rate, we must first determine which mortgage option best suits your needs.

Not all mortgages are created equal, and sometimes the 'best' rate does not lead to the 'best' results.

With the real estate market gaining consistent traction, mortgage rates and promotions are regularly making headlines in the Canadian news. People are buying homes, renewing or re-financing their existing mortgages while focusing solely on the "best rate" available. I can understand the temptation to search the internet for the lowest possible rate and "sign your life away," but not all mortgage products are the same. As strange as it may sound – There are more mortgage factors to consider than just the rate.

To be clear: Instead of signing your life away, you're starting a new, exciting stage!

Chances are you've seen or heard of major banks and notable lenders introducing:
- No Frills Mortgages.
- Deep Discount Mortgages.
- Low Rate Basic Mortgages.

Don't be fooled. A more appropriate name for any of the above would be a "Restrictive Mortgage" or even worse: "A Handcuffed Mortgage." These mortgages will offer you rates that area 0.10% - 0.15% lower than standard mortgages, but odds are they come with one or more of the following conditions:

1. Shockingly Higher penalties – Often 3 times higher than a standard mortgage.
2. No Way Out – The only way you're free of your mortgage is if you sell, and even if you re-finance, you're locked into the same lender.
3. The inability to Port and Blend – If you had to move, you'd be penalized because most likely you'd require additional funds to assist with the moving process. The only way you wouldn't be penalized is if your new mortgage amount stays the same or is less.

4. Lower pre-payment privileges.
5. A lower amortization period.

Odds are, conditions #4 and #5 won't impact your overall decision, but conditions #1 - #3 are important factors to steer clear of, if possible.

Consider the following scenario:

You're been offered:

1. A "no frills" 5-Year Fixed mortgage at a rate of 2.89%
2. A "standard" mortgage at a rate of 3.04%

Your monthly payments end up being $38 less with mortgage #1, which leads to a savings of $1235. But is it worth it?

By choosing scenario #1, you're essentially deciding that:

- You're not going to move, or increase your mortgage payments.
- You're not going to re-finance in the event a new lender offers a better rate.
- You're not going to increase your amortization to reduce your payments.
- You're not going to sell your house, even in the event of a divorce, annoying neighbour or a break-in.
- Accept a job where your income is reduced which makes you unable to meet the financial requirements from your lender.
- You're not going to access additional funds in the event of debt, changes in health, etc.

*30-40% of my clients will contact me during the first 3-4 years of their mortgage term, inquiring about a change.

Of course a low rate is important, and my job is to help you save as much money as possible. But my greater responsibility is to ensure that you are in a mortgage that leaves you flexible, comfortable and informed.

Once you learn the rate that lender is offering, your next question should always be: **"Does this mortgage come with restrictions?"**

Together we will make sure that we ask the right questions, while protecting you and your family, and getting the straight goods on exactly how much money your mortgage will be costing you in the long run.

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4.KNOWING THE ESSENTIALS BEFORE SIGNING A MORTGAGE COMMITMENT

What you need to know before you sign on the dotted line...

The rate/length of a mortgage is important yes, but before you commit to a mortgage lender, you need to understand the "fine print" of the agreement and all contracts therein.

I've lost count of how many times I've spoken with a disappointed homeowner who committed to a mortgage, only to later find that they didn't fully understand the terms that they had signed up for. It should be obvious to this point, but to be clear: Not all mortgages are the same.

Here are some terms and items to consider before you officially commit to a mortgage:

1.PORTABILITY
Portability is defined as: A mortgage that permits the mortgage borrower to transfer their mortgage balance to a new property (using the same lender) without penalty. The exact terms of the first mortgage stay the same after the transfer.

This is an important feature and pretty much a given for all mortgages. However, the rules associated with portability differ with each lender.

- If you complete the sale of one property with the plan of then completing a purchase for a new one - Some lenders allow 30 days while others allow up to 90. This is an important factor if you sell your home, but can't find/complete the purchase of a new home quickly. This happens often.
- When you port your mortgage to your next property, odds are you'll need a larger mortgage. Will your mortgage allow you to increase your mortgage amount and blend your rate? Some lenders are happy to offer this option, while others do not. If the lender does not offer this option, then you'll be forced to pay a mortgage penalty. A huge advantage of being able to port your mortgage is having the ability to continue with your current mortgage rate without having to pay a penalty. This becomes especially relevant if rates have risen.

- Portability in a Variable Mortgage – In most cases, you can port your mortgage in a VRM, but you may not be able to increase your next mortgage amount unless you pay the penalty and sign a new contract. Typically the penalty only costs 3-months of interest, and it's still worth it to attain a lower mortgage rate.

2.WHAT IS THE PENALTY AND HOW IS IT CALCULATED?

If you have chosen a VRM the standard penalty is only 3-months of interest. But if you've chosen a Fixed Rate Mortgage, lenders will charge you the greater amount of either a 3-month interest penalty or the IRD (interest rate differential).

This is where we work together and we ask the tough questions. Because this decision could end up saving you thousands of dollars in the long run. Knowing the penalties and how they are calculated is very important, and not all lenders calculate their IRD penalties the same.

A majority of the big banks will calculate your IRD penalty based on their "contract rate" and compares it to the "posted rate" that most closely matches your remaining term MINUS the original discount you got off of their five-year posted rate.

Now let's make you an expert on the single most important small-print detail in your fixed-rate mortgage contract.

For starters, while it may come as a surprise, almost all Canadian lenders use the same basic wording for their fixed-rate mortgage penalties, which they typically describe as "the greater of three months interest or interest-rate differential (IRD)".

The key difference is in the actual rates that are used in the IRD calculation, and to illustrate these with examples, let's start with the following assumptions:

- You have a five-year fixed-rate mortgage at a rate of 2.19% with a current balance of $350,000.
- You are three years into your five-year term (with two years remaining).
- Interest rates are the same today as they were when you first got your loan.

First, let's calculate the cost of three months' interest. Here is the formula:

2.19% X $350,000 X (3/12) = $1,916.25

Lenders simply compare this cost to their IRD calculation and charge you the higher of the two amounts.

IRD penalties are typically calculated using one of three methods: Standard, Discounted or Posted.

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The Standard IRD Calculation

When using a standard IRD penalty calculation, your lender takes the difference between your contract rate (2.19%) and their current rate that most closely matches the time remaining on your term. Because you have two years left on your mortgage, in this case the lender would compare your contract rate to their current two-year fixed rate. (We'll use 1.69%, which is a competitive two-year rate today.)

The lender takes the difference between these two rates (which works out to 0.50% in this example), and multiplies it by both your mortgage balance and the time remaining on your mortgage (expressed as the number of months remaining on your mortgage divided by twelve).

Here is the complete formula:

$$(2.19\%-1.69\%) \times \$350{,}000 \times (24/12) = \$3{,}500$$

That's it! If you understand this example, then you have mastered the Standard IRD calculation. This is used by a wide range of Monoline lenders who compete with each other to offer borrowers the best mortgage rates available.

In this case the cost of three months' interest ($1,916) is less than the lender's Standard IRD calculation ($3,500), so you would have to pay $3,500 to break your mortgage.

Now here is where a little knowledge can save you some serious money.

Other well-known lenders have tweaked their IRD calculations to skew the interest rates used in their formulas heavily in their favour, and as you will see, that can have a huge impact on the size of your penalty.

The Discounted-Rate IRD Calculation

This is IRD calculation is used by most major banks.

The key difference in the Discounted Rate IRD method is that the lender takes your contract rate and compares it to the posted rate that most closely matches your remaining term MINUS the original discount you got off of their five-year posted rate.

To put that in today's terms, the Big Six Banks' five-year posted rates currently average 4.79%, so a contract rate of 2.19% comes with an average Big Six discount of 2.60%.

To highlight with a specific example, here is the IRD penalty wording taken straight from TD's website. I have underlined the key section:

[Your contract rate will be reduced by] the current interest rate that we can now charge for a mortgage term offered by us with the term closest to your remaining term. The interest rate will be our posted interest rate for the term minus the most recent discount you received

In other words, lenders who use this method will take the original discount they gave you off of their five-year posted rate and apply that same discount to the posted two-year rate they use to calculate your penalty.

This subtle tweak to the IRD fine-print wording makes a huge difference to the cost of your penalty, and is blatantly one-sided because lenders don't discount their shorter-term fixed rates nearly as deeply as they do their five-year fixed rates.

Look at the difference that this wording makes to your IRD penalty calculation:

(2.19% - .54%) X $350,000 X (24/12) = $11,550

The information below summarizes the key numbers that are used in the Discounted Rate IRD formula that is used both by TD and by most of the other Big Six banks:

- Your Contract rate 2.19%
- Posted rate that most closely matches your remaining term 3.14%
- Discount you received on your original contract rate 2.60%
- Two Year Rate used to calculate your penalty .54%
- Mortgage Balance $350,000
- Months remaining 24
- IRD Penalty $11,500

I know. Ouch.

Choosing the right lender can make all of the difference!

3.WHAT ARE THE PRE-PAYMENT TERMS

All lenders will allow you to pre-pay a certain portion of your mortgage amount each year while also allowing you to increase your payments. Some will allow you to prepay up to 10% while others will allow up to 30% of your original mortgage amount each year.

It seems straight forward, but if you dig a little deeper you'll discover that some lenders only allow you to make a lump sum payment on your mortgage anniversary date, while others enable you to make pre-payments any time. If you're limited to making a lump sum payment on your anniversary date, you'll be paying way more interest while you wait for that anniversary date to arrive.

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4.IS YOUR MORTGAGE CHARGE “COLLATERAL” OR STANDARD?

There are two ways a lender can register a mortgage loan: They can use a standard mortgage charge or a collateral charge.

With a standard mortgage charge, the lender registers your home with the land title/registry office in your Municipality which then means that your mortgage can be registered, transferred or discharged from your lender with ease and minimal cost.

A collateral charge, on the other hand, is a blanket charge against your property and can only be registered or discharged from your lender. It cannot be transferred. A collateral mortgage makes sense if you think you may need to borrow more money during the term of your mortgage. This charge then allows you to increase your mortgage with little cost.

If you don’t need to access extra funds during your mortgage term, a standard mortgage charge is highly recommended.

5.CHOOSE THE RIGHT MORTGAGE PROVIDER

The largest financial transaction of your life is too important to place in the hands of someone who is not capable of properly advising you/dealing with any issues that may occur along the way…

Here are a few questions to ask your lender in the early stages of your discussions. If they don't answer these questions correctly and confidently – Take your search elsewhere!

1.WHAT ARE MORTGAGE INTEREST RATES BASED ON?

The ONLY correct answer is that fixed residential mortgage rates are determined by changes in the bond market and the competitiveness of the chartered banks in Canada.

For variable mortgages, banks use the overnight rate as a guide to establishing the Prime rate, which is influenced by The Bank of Canada.

Knowing the basics of how interest rates are determined is a "must" for any mortgage professional. Do not work with a lender who focuses on the wrong indicators or who has no idea what the indicators even are.

Our entire team makes it a priority to regularly review and study these indicators to best serve your needs. You can take full confidence in our ability to suggest and implement the best mortgage strategy to suit your needs, ensuring that we position you for long term success.

2.HOW WILL RISING INTEREST RATES IN THE COMING YEARS AFFECT ME IF I TAKE A FIXED RATE PRODUCT?

Most lenders will wrongfully tell you that a fixed rate product means that future rising rates won't affect you. Not only is that wrong, but it's reckless and lazy.

Rates today are historically low, but when it comes time to renew your mortgage and the rates have normalized (possibly as much as 2% higher), you will have arrived at "payment shock" which can be risky to your long term financial health.

They key is to find a lender that will diligently monitor your mortgage and will notify you when rates rise. From there, they should be able to suggest ways to minimize payment shock. This simple courtesy could end up saving you thousands of dollars.

3.WHAT STRATEGY ARE YOU RECOMMENDING AND WHY?

The key word in all of this is “strategy.”

If your lender can’t clearly explain and justify the strategy behind their recommendations, then all they’re really doing is quoting a rate.

When you’re making a large financial investment, it only seems fitting that you’d deal with someone who has a solid financial plan and is making your financial wellness their top priority.

4.WHAT STEPS WILL YOU TAKE TO PERSONALLY MANAGE MY MORTGAGE OVER THE LONG TERM?

Is there a more important or relevant questions than this one?

Many lenders, especially bank personnel, have little desire or ability to proactively manage your mortgage in the long run. If the markets are constantly changing, but nobody is watching your back, how will you be able to make the most of the changing markets?

Ultimately you want someone who is going to help you renegotiate if there’s a more beneficial opportunity that presents itself down the road.

Another way of looking at it is: Why would you choose a variable rate mortgage, only to then NOT have somebody keeping a close eye on things for you.

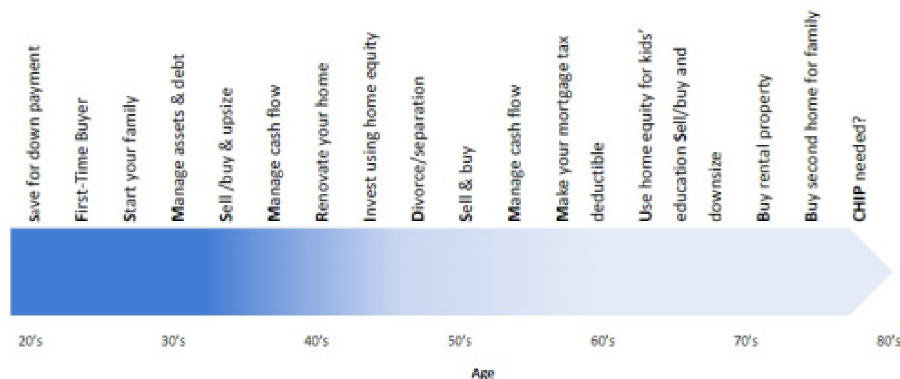
Almost anybody can sell you a mortgage, but only truly committed mortgage professionals can effectively manage your mortgage over the long term. I passionately believe that the “real” job of the mortgage professional begins once the mortgage has been arranged.

By prioritizing consistent, long term management, the right mortgage professional will significantly reduce your total cost of home ownership.

6. UNDERSTAND THE IMPORTANCE OF THE LENDING CYCLE

The Lending Cycle (see figure below) provides an outline of the stages that a homeowner will commonly experience during the lifespan of homeownership. Not everyone will experience every step, but everyone should be able to relate to the basic premise that I've outlined below.

WHERE DO YOU FIT IN THE LENDING CYCLE AND WHAT ROLE COULD YOUR MORTGAGE HAVE?



SAVE FOR A DOWN PAYMENT

A down payment is essential when buying a home. The minimum down payment right now is 5% of the purchase price. When planning to buy a home, many people choose to withdraw funds from their RRSP savings under the Home Buyers Plan. For tax purposes, this is a popular route to take.

FIRST-TIME BUYER

If you have never owned a home before, you are a First-Time Buyer. In British Columbia, there are two huge privileges that come with being a First-Time Buyer:

1. You can draw from RRSP's without being taxed.
2. You are exempt from paying the property purchase tax/land transfer tax.

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START YOUR FAMILY

Once you've entered the real estate market, you'll discover benefits that will set up your family for short-term and long-term success. In the short-term you've got a comfortable place to raise a family and the pride of homeownership. In the long run you're building equity and savings through the value of your home. When you make payments, you're essentially paying yourself.

MANAGE ASSETS & DEBT

Homeowners utilize their equity in different ways. Some choose to draw from their equity to purchase another property. While others will use their equity to consolidate debt, renovate their home, or to invest in other ventures. Good or bad, your mortgage prepares you for life's surprises.

SELL/BUY & UPSIZE

On average, homeowners will buy and sell a home ever 5-7 years. As families grow, needs change. Keeping your equity high will largely depend on the costs associated with buying and selling your properties and the type of mortgages you choose.

MANAGE CASH FLOW

Managing cash flow is always important regardless of your life's circumstances. Low mortgage payments can help, especially during years when cash flow might not be at a premium. Expenses will continue to rise and circumstances will continue to change, so managing your cash flow should always be top of mind.

INVEST USING HOME EQUITY

Home equity in Canada is highly under-utilized. Drawing equity from your home to use for other investments/pursuits can make your mortgage tax deductible while also helping you expand your overall net worth.

DIVORCE/SEPARATION

Unfortunately, not all married couples stay married. Divorce and separations can be costly to both spouses. Programs and options are available to homeowners to make this difficult transition as affordable and as manageable as possible. The goal here is to keep as much equity in your pocket while making every plausible effort to keep the home for the family's use.

MAKE YOUR MORTGAGE TAX DEDUCTIBLE

As home equity increases, some homeowners decide to use equity to pursue investments that will make their mortgage tax deductible. There are tax-efficient mortgage options available that are ideal for this type of financing.

USE HOME EQUITY FOR KIDS

As you age, you may find that you'll need to access home equity to help pay for your child's educational/ athletic/ artistic pursuits.Home equity can often be the most cost effective approach to help with these endeavors.

SELL/BUY AND DOWN SIZE

Hopefully by this point, persistence has paid off and your longevity in the real estate market has eased your financial stress. Your children may also be starting to experience the lending cycle themselves and without even realizing it, your home is starting to feel empty. Maybe now it's time to sell, downsize and use some of your home's equity for retirement.

BUY A RENTAL PROPERTY

As your equity increases, some homeowners will choose to purchase a second property, which further improves their financial situation.

BUY A SECOND HOME FOR THE FAMILY

Buying a second home is becoming more common now that real estate prices are soaring. You might be helping your children, or your elderly parents, or your work/leisurely travel might make a second family home necessary. Regardless of your situation, we have a Vacation/Secondary Homes Program that can help.

CHIP NEEDED?

The Canadian Home Income Plan (CHIP) is a mortgage that allows you to access equity during retirement without the need to make a payment. This is just one further way to use the equity you've built for yourself to your advantage.

7. MAKE YOUR MORTGAGE TAX DEDUCTIBLE

Strategies for turning your bad debt into good debt…

Debt can be good thing when it's tax deductible. Lowering your taxes never hurts! There are two advantages/purposes to this concept:

1. CREATE CASHFLOW AND HAVE A TAX STRATEGY
Have your investment return exceed the costs of your monthly borrowing (ideal for homeowners over 50 that have debt/a mortgage).

2. CREATE AN EFFECTIVE INVESTMENT PORTFOLIO AND HAVE A TAX STRATEGY
If you're between 30-50 and you're goal is to re-invest the amount of money that you've paid into your mortgage, here's a general idea of how this can work:

- Make your mortgage payments and increase your equity.
- Once you've built up equity, you can invest it.

Yes you'll pay interest on your home equity line of credit, but you'll also receive a tax deduction. Plus if your investments pay off, hopefully you'll end up with a return that is higher than the interest rate on your equity loan.

The primary goal of this strategy is to increase cash flow and the value of your assets while decreasing liabilities. Additionally, this strategy can also help you become mortgage-free faster while building up a larger investment portfolio.

If you choose this strategy, the mortgage choice you make is important. You'll want to choose an all-in-one "multi purpose" product. This type of mortgage is advantageous to investors and entrepreneurs.

If you need to access funds quickly, this choice will also make life easier come tax time when taxes need to be filed.

With this choice you can split your mortgage into numerous tiers, giving you the flexibility to label/name all of your financing tiers and to keep track of tax-deductible interest.

These options may also allow you to have different financing categories for different components of your all-in-one mortgage. Think of it like having the flexibility to handcraft the best combination of products and rates for your various individual needs.

To learn more about this strategy, I would suggest the following books: “The Smith Manoeuvre” by Fraser Smith and “Turn Your Mortgage Into a Pension” by Gordon P. Johnson. Each book provides a unique perspective on how you can make your mortgage tax deductible.

A FRIENDLY NOTE OF CAUTION…

This strategy is not for everyone. Borrowing against your home can be tough to rationalize, and if your investments don’t pan out, it could lead to unexpected negative consequences.

By re-borrowing the equity in your home, you are also removing you safety net in the event that markets take a turn for the worse. There could also be additional tax consequences if your income is not properly documented. Always consult with a financial advisor to determine whether this strategy makes sense for you. And if so, make sure that you have it tailor-made to give you and your family the best chances for sustained success.

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CONTACT US

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