

Credit and the Things They Never Tell You

with **Steve Bang**

Credit and the Things They Never Tell You

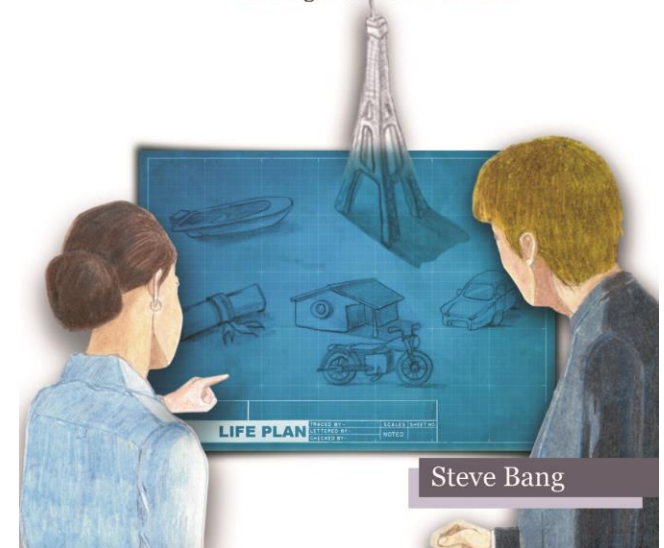
Welcome Everyone

Steve Bang BA, MBA, CFP

- Fellow of the FPSC
- 29 Years at BMO
- Professor of Business
Humber College (8 Years)
- Author of Planning to Borrow

Planning to Borrow

A Practical Guide to Consumer
Lending Practices in Canada



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Diane and Bob are Stressed About Stress Tests

- House Price = \$625,000 Down Payment = \$125,000
- Loan to value = 80%
- Mortgage Required = \$500,000
- Taxes = \$3,600/year
- Heating = \$150/mth
- Combined Gross Income = \$120,000
- Car Payment = \$300/mth
- Credit Card Limit = \$8,000
- Market Mortgage Rate = 3.5%
- Maximum Mortgage Approved = \$448,000



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Stress Tests – Solution

Gross Debt Service Ratio = $\frac{\text{Mortgage Payment} + \text{Taxes} + \text{Heating}}{\text{Gross Monthly Income}}$
(GDSR)

$$.32 = \frac{\text{Mortgage Payment} + \$300 + \$150}{\$10,000}$$

$$\$3,200 = \text{MP} + \$450 \quad \text{Mortgage Payment} = \$2,750$$

$$\text{TDSR} = \frac{\$2,750 + \$300 + \$150 + \$300 + \$400}{\$10,000} = .39 = 39\%$$

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Maximum Mortgage Available (25 year Amortization)

Based on Market Rate of 3.50%

= \$549,315

Based on Stress Test Rate of 3.5% + 2% = 5.5%

= \$447,819

$\$549,315 - \$447,819 = \$101,496$



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What Can Diane and Bob Do?

- Purchase a less expensive house 👎
- Borrow from family or friends 👎
- Apply for a mortgage at a Credit Union or Caisse Populaire 👍



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Harold and Gale Have an Unexpected Life Event

- Goal - retire in 10 years at age 60
- Gale to take a 1 year leave of absence
- Estimated cash flow deficit of \$32,000
- \$400,000 Whole of Life Joint and first to die insurance policy not required for retirement funding
- Original mortgage \$700,000 at 3.75%, 25 year amm. and payments of \$3,600/mth (10 years ago)
- Current mortgage balance \$420,000 at 3.75% with 10 years remaining and payments of \$4,200/mth

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Life Event – Solution

Option #1 – Borrow from the Life Insurance Policy

- Lots of Current Cash Surrender Value
- Relatively quick and easy process
- No immediate repayment required so no drain on cash flow
- Re-payment can happen once Gale returns to work



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Life Event - Solution

Option #2 – Mortgage Restructuring

Contracted Mortgage Balance

Based on payments of \$3,600/month

$$= \$494,728$$

Cash Account Balance

$$= \$494,728 - \$420,000 = \$74,728$$

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Life Event - Solution

Option #2 – Mortgage Restructuring (continued)

- Assume \$20,000 taken from cash account
- Assume re-payment returns to original Amortization (15 years left)
- Mortgage Balance = \$440,000
- Revised Mortgage Payment = \$3,200/mth
- Mortgage Payment savings = \$1,000/mth

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What Options do Harold and Gale have?

- Borrow \$32,000 from their life insurance
- Borrow \$20,000 from their life insurance and reduce their mortgage payments to \$3,200/mth
- Withdraw \$32,000 from their Mortgage Cash Account and keep their \$4,200/mth payments
- Withdraw \$20,000 from their Mortgage Cash account and reduce their payments to \$3,200/mth

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Jane and Monique want to Travel the World

- Original mortgage amount = \$600,000
- Current mortgage = \$380,000, 4 year term remaining, interest rate of 5.25%
- Current market rate for 4 years = 3.75%
- Current house value = \$1,000,000
- Mortgage Penalty = \$22,800
- Both Taking a 1 year leave of absence



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Travel the World – Solution

Three month's interest penalty
 $= \$380,000 \times .0525 \times 3/12 = \$4,987.50$

Rate Differential Penalty
 $= \$380,000 \times (.0525 - .0375) \times 4 = \$22,800$

Note: In this case the lending institution would apply the rate differential penalty of \$22,800

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How can Jane and Monique reduce their penalty?

- Apply the 20+20 prepayment before total repayment
New mortgage balance = $\$380,000 - \$120,000 = \$260,000$
Revised Penalty = $\$260,000 \times .015 \times 4 = \$15,600$
(\$22,800 - \$15,600 = \$7,200 savings)
- Ask for the penalty to be reduced or waived based on the new funds on deposit
- Commit to taking out a new mortgage upon returning from the trip and request a penalty refund at that time

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Raj's Rate is on the Rise

- Large property tax increase creating financial stress
- Two interest rate increases forecasted for the next 2 months
- Mortgage due for renewal in 6 months
- Unable to handle increased mortgage payments



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What can Raj do?

- Renew his Mortgage Early (up to 6 months)
- Surf the net to find out the current rates
- Meet with his Branch Manager and ask for a discount on the posted rates



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Lisa's Annual Credit Check-up

- Interest rates have fallen in the past 2 years and the banks prime lending rate is 2.5%
- Lisa has \$10,000 left to pay on a consolidation loan at 8.5% with 3 years remaining, secured by a \$30,000 GIC
- Lisa used her \$15,000 line of credit to buy a \$14,000 vehicle and her rate is 7% (she has been making payments of interest only = \$82/month)
- Lisa has a Bay Credit Card with a limit of \$5,000 and a balance of \$3,000 (29% interest) and a Visa card with a limit of \$5,000 and a balance of \$500 (18% interest)

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Lisa's Annual Credit Check-up – Solution

Lisa's Credit Summary

Cons. Loan	\$10,000	36 x \$320	= \$11,520
Line of Credit	\$14,000	60 x \$277	= \$16,620*
Bay Card	\$3,000	28 x \$150	= \$4,200
Visa Card	\$500	24 x \$25	= \$600
Total	\$27,500	\$772	\$32,940

*assumes full payout in 5 years

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What Recommendations do you have for Lisa?

- Consolidate all the lending products and pledge the GIC as collateral. Fully secured rate = Prime+2% = 4.5%
- New Payment = \$513/mth (\$64/mth less than she is currently paying and \$259/mth less than she would be paying if she paid the Line of Credit off in 5 years)
- Total repayment = $\$513 \times 60 = \$30,780$
- Overall Savings = $\$32,940 - \$30,780 = \$2,160$

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Additional Suggestions for Lisa

- When rates decrease refinance fixed repayment loans
- Avoid making large purchases with revolving credit products such as a line of credit
- Using a retail credit card for points is fine but pay it off within the grace period by using a credit product with a lower rate such as a line of credit or another credit card.



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Some Additional Credit Related Tips

- Avoid Finance Company Loans
- Watch out for Interest Penalties
- Take control of your Collateral
- Mortgage Cash-back versus Reduced Rate

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Thank You