



What does material risk mean?

Whether a risk is material depends on the specific circumstances of the mortgage transaction and the parties involved. A risk is generally material if it could reasonably influence the borrower's or lender's decision to proceed with the transaction.

Material risks related to dealing in mortgages may include

- a borrower chooses a variable-rate mortgage without adequately planning for the possibility of significantly higher payments in the future
- the lender approves loans primarily based on property value rather than the borrower's ability to repay, resulting in higher interest rates, stricter default terms than other lenders, or both
- the mortgage is a reverse mortgage or other type of specialized mortgage product with unique features and risks
- the mortgage has a long amortization period and low payment structure that could cause the loan balance to increase rather than decrease over time, increasing overall debt
- significant penalties or fees apply if the borrower wants to refinance, sell the property, or repay the mortgage before the term ends

In relation to mortgage lending, material risks may include

- a history of missed mortgage payments by the borrower
- the borrower is in arrears on existing mortgages, property taxes, income taxes, strata fees, or a combination of these obligations
- the mortgage will be registered behind one or more other mortgages on the property
- a high loan-to-value ratio or the possibility that changing property values could increase the loan-to-value ratio beyond expectations

Material Risk (Copy and Paste Examples) for Forms 6A (Borrower) and 6B (Lender)

Borrower Material Risks

Risk of Arrears

Regular mortgage payments must be made on the specified due date. Failure to make payments on time may result in accrued interest, penalties, and damage to your credit rating. Persistent arrears could lead to serious financial consequences, including default.

Risk of Default and Foreclosure

If you fail to make payments, your lender may initiate foreclosure proceedings, potentially resulting in the sale of your property. If the sale price does not cover your outstanding mortgage balance, you may be responsible for the shortfall and any associated legal costs.

Risk of Prepayment Penalty

Exceeding the allowable prepayment limit may result in significant penalties. Penalties are most common when you sell your property without porting your mortgage or break your term early.

Fixed-Rate Mortgage (Closed Term)

This mortgage features a constant interest rate for the term, providing payment stability. However, if market interest rates decrease during the term, you will not be able to refinance or pay out the mortgage early without incurring significant prepayment penalties and/or additional costs. Additionally, if you decide to sell the mortgaged property, you may face prepayment penalties and/or additional costs to discharge the mortgage before the end of the term.

Variable-Rate Mortgage

This mortgage has a variable interest rate, but the payment remains fixed unless adjusted by the lender. If the prime rate increases, the fixed payment may become insufficient to cover the interest portion of the mortgage. This can lead to negative amortization, meaning unpaid interest is added to the principal balance, increasing the overall debt. To prevent negative amortization, the lender may require an increase in the

fixed payment amount or a lump sum payment. This scenario can affect cash flow, as borrowers may need to adjust their budgets to accommodate increased payments.

Adjustable-Rate Mortgage

This type of mortgage has a variable interest rate, and the payment amount fluctuates in response to changes in the lender's prime rate. If interest rates increase, the payment amount automatically adjusts upward to ensure that sufficient funds are applied toward both interest and principal. This prevents negative amortization (where the mortgage balance increases instead of decreasing). Because the payment is recalculated each time the prime rate changes, borrowers must ensure they have sufficient funds to accommodate potential payment increases. This feature introduces cash flow uncertainty for borrowers, as their mortgage payments can rise or fall depending on interest rate movements.

Interest-Only Mortgage

Payments cover only the interest, leaving the principal unchanged. This could result in lower equity at the end of the term, especially if property values decline.

No Frills and Discounted Mortgages

These mortgage products offer lower interest rates but come with various restrictions that may limit flexibility:

- They often have significantly higher penalties for breaking the mortgage early.
- Some products include a bona fide sale clause, meaning the mortgage can only be discharged if the property is sold to an unrelated third party.
- Certain lenders may prohibit breaking the mortgage entirely, restricting refinancing or early repayment options.
- Prepayment privileges may be limited, reducing the borrower's ability to make extra payments or payoff the loan ahead of schedule. Borrowers should carefully review the terms and conditions to fully understand the restrictions and potential costs associated with these mortgage options.

Reverse Mortgage

A reverse mortgage allows homeowners to borrow against their home's equity without making regular payments. Instead, interest accumulates on the outstanding balance, compounding over time and increasing the total amount owed.

- The growing loan balance may significantly reduce home equity, potentially leaving less for inheritance or future financial needs.

- Repayment is typically required when the homeowner sells the property, moves out, or passes away.
- Additional costs, such as higher interest rates and fees, may apply compared to traditional mortgages. Borrowers should carefully consider the long-term impact on their financial situation and estate planning.

Extended Amortization

Mortgages exceeding 25 years result in higher total interest costs over the life of the loan. Failing to reduce the amortization period upon renewal could further increase these costs.

Hybrid Mortgage and Home Equity Line of Credit (HELOC)

A hybrid mortgage combines a fixed-rate or variable-rate closed-term mortgage with an open home equity line of credit (HELOC). This structure provides both stability and flexibility but comes with important considerations:

- **Fixed or Variable Closed-Term Component:** A portion of the mortgage is locked in at either a fixed or variable rate for a predetermined term. While this provides predictable payments, prepayment penalties may apply if the mortgage is broken before the term ends.
- **Open HELOC or Main Account:** The remaining portion functions as a revolving home equity line of credit, which remains open for withdrawals up to a pre-approved limit. HELOC interest rates are typically variable and fluctuate with changes to the Prime rate, meaning payments may increase if interest rates rise.
- **HELOCs offer repayment flexibility,** as borrowers can make interest-only payments or repay the balance at any time without penalties. While hybrid mortgages offer access to home equity and potential interest savings, borrowers should carefully assess their repayment strategy and ability to manage fluctuating HELOC payments.

Compounding Periods

The frequency at which interest is compounded can impact the total cost of borrowing.

- Most lenders in Canada compound interest semi-annually (every six months) for fixed-rate mortgages, which is the industry standard.
- Some lenders may use monthly compounding, particularly for certain variable-rate products, which results in more frequent interest calculations and slightly higher overall interest costs over time.

- HELOCs typically have monthly or daily interest calculations, meaning interest accrues more frequently but only on the outstanding balance. Borrowers should verify the compounding method with their lender, as this can affect the long-term cost of the mortgage.

Collateral Charge Mortgage

The full loan amount is registered against your property, which may limit future borrowing capacity or complicate switching lenders.

Cash Back Option

Mortgages offering cash back often come with higher interest rates. If you refinance or break the mortgage early, you may be required to repay the cash-back amount.

Fully Open Mortgage

Fully open mortgages allow for prepayment without penalties but usually come with higher interest rates, increasing overall borrowing costs.

Bridge Financing

Bridge loans carry higher interest rates and are intended to cover short-term financing gaps. Delays in property transactions may result in additional financial strain.

Insured Mortgage

Default insurance premiums are non-refundable and add to the cost of borrowing. These premiums remain even if the mortgage is discharged early.

Legislative Changes

Unanticipated changes to legislation could result in a lack of ability to port and increase your mortgage using your existing mortgage rate and term. This may result in a penalty to you the client.

Lender Material Risks

History of Missed Payments

A history of missed or late mortgage payments by the borrower increases credit risk, potentially leading to default, accrued interest charges, legal costs, and difficulties securing future financing.

Arrears on Existing Obligations

The borrower is in arrears on existing mortgages, property taxes, income taxes, strata fees, or a combination of these obligations. Outstanding arrears can result in tax or strata liens being registered against the property, which may take priority over or compromise the lender's security position.

Subordinate Mortgage Registration

The mortgage will be registered behind one or more existing mortgages on the property (e.g., second or third position). In the event of default and foreclosure, prior charge holders are paid first, increasing the risk that insufficient funds will remain to satisfy the balance of subordinate mortgages.

High Loan-to-Value (LTV) Ratio

A high loan-to-value ratio, or the possibility that declining market property values could increase the loan-to-value ratio beyond expectations, leaves less equity cushion to protect against default, potential property damage, or market downturns.

Non-Traditional or Fluctuation Income

Reliance on non-traditional, seasonal, commission-based, unverified, or self-employed income sources that may fluctuate or cease unexpectedly, impairing the borrower's ability to maintain regular debt service.

Elevated Debt Service Ratios

Borrower debt service ratios (such as GDS and TDS) that exceed standard benchmark guidelines limit financial flexibility, leaving little buffer to absorb unexpected life events or rising living expenses.

Interest Rate Fluctuations and Shock

Mortgages with variable or adjustable interest rates expose the transaction to market rate increases, which can lead to sudden payment increases or trigger rate scenarios where payments no longer cover accumulating interest.

Renewal and Refinancing Risk

Changes in regulatory qualification requirements, altered borrower credit profiles, or declining property values may restrict the borrower's ability to refinance or qualify for competitive terms upon mortgage renewal, forcing higher interest rates or private financing options.

Short-Term Loan Payout Risk

Short-term mortgages require a full payout, refinancing, or property sale within a compressed timeframe. If the intended exit strategy fails or is delayed, the borrower faces default, extension fees, or forced property sales.

Restrictive Terms and Penalties

Mortgages containing significant prepayment penalties, strict early payout conditions, or bona fide sale clauses restrict the ability to discharge or refinance the loan without incurring substantial costs.

Non-Conforming Property Characteristics

Uninsurable, non-conforming, or high-risk property characteristics—such as environmental contamination, unauthorized suites, structural deficiencies, heritage designations, or construction delays—can reduce marketability, impair property value, and complicate foreclosure recovery.

Equity Erosion via Compounding Interest

Structures where interest compounds or is added to the principal balance over time (such as reverse mortgages or interest-deferral options) steadily erode home equity, reducing the net value available upon eventual sale or refinancing.

Leasehold Land Expirations

Properties situated on leasehold land with short remaining terms can experience declining property value and reduced marketability, complicating future financing, sales, or lender recovery efforts.

