Welcome to the World of Loans

Now that you have learned about credit cards there is another kind of debt you can incur during your life. A loan is taken out with a bank when you want to borrow a larger amount of money. There are 3 main types of loans listed below:

**Personal Loan:** This is a loan that you take out for items that are fairly large and will take you a period of time to pay back to the bank. The bank will typically suggest this type of loan for items such as: a vehicle, home renovations, boat, or a trailer. There is usually a repayment schedule attached to the loan where the money would be repaid in a specific amount of time. The payments are then set at an amount intended for you to repay in that time period. For example, if you got a loan for a car you might have to pay $400/month for 6 years to pay off the car in that time.

**Line of Credit:** This is a loan that allows you to borrow and repay whenever you want. You can repay as much or as little as you want every month. The bank will continue to charge you interest for the loan as long as you owe money on the line of credit. Typically, this type of loan would be used to purchase something smaller that you intend to pay back in a few months or years. For example, the bank gives you a line of credit for $5000 and you can use that money for whatever you want. You can also take as long as you want to pay it back. Interest is only calculated on the amount of money that has been borrowed. If you only use $2000 then you only pay interest on that money instead of the whole amount you could borrow.

**Mortgage Loan:** This type of loan is intended to purchase a home. It is similar to a personal loan but is typically for amounts in the hundreds of thousands of dollars. A set payment schedule is made for you and you typically have 20-30 years to pay back the loan.

**Part 1: Find a House to Buy**

1. In the budget information and spreadsheet you have been working on, you recorded your information based on renting a place. Now you are going to calculate a budget as though you could afford to purchase a home.

A. You will need to copy and paste some of the information from your previous budget spreadsheet (called “Rental”) into the “Mortgage” tab on the bottom left corner of the Excel document.

B. On the copied spreadsheet delete the information you provided in the rental property category.

C. You are now going to shop the internet for a home of your choice in Saskatoon or the city you live in. Use the links provided on the project website to shop for a home. Pay close attention to the price as you shop.

**Part 2: Check to See if You Can Afford the Home**

Once you find a place that you like, you will need to calculate if you can afford the home based on your current Net Monthly Income. Use the mortgage calculator link provided on the project website page called “**Mortgage Qualifier Tool”**

**Setup:**

* **Property Value:** This is the asking price for the home you want to purchase. A home’s price can always be negotiated down but for this assignment let’s just use the actual price of the home.
* **Down Payment**: This is your own money given at the time of purchase that indicates to the bank that you are willing to invest some of your own money into owning the home. You currently must have at least 5% of the value of the home so we will use that percentage in the calculator tool.
* **Annual Interest Rate**: This rate is partially decided by the Bank of Canada, which is called the Prime rate. However, banks will add their own interest rate on top of this rate to make money on the loan as well, since they are a private business. This rate often ranges so you may want to Google “Canada Prime Rate”. Typically, Prime ranges between 2-5% these days. You will want to look at mortgage rates for a specific bank. Choose a Canadian bank and find their current “mortgage rates” on their website.
* **Amortization**: This is how long it will take you to pay back the entire loan. For this assignment let’s use 25 years.
* **Payment Frequency**: This is how often you are going make a payment towards the loan. It can range from monthly, bi-weekly, or weekly. Most people choose to pay this on a monthly schedule to align with their pay cheques. Let’s choose to make monthly payments.
* **Term**: This is how long the bank will guarantee you the specific rate you use for an interest rate for the mortgage. The banks do this to protect themselves or you in case the prime interest rates go up or down. You and the bank don’t want to lose money, so they typically only guarantee an interest rate for 5 years or less. Often you can choose a variable rate (changes with prime rate) or a fixed rate (locked at a certain number for the term) for those 5 years. Let’s make the term 5 years for our calculations.
* **Gross Income:** The bank needs to know how much money you make in a month or year to see if you can afford to pay for this home. You can use your Gross Monthly Salary from your spreadsheet or Gross Annual Salary. Just make sure you change the drop-down menu to say “yearly” or “monthly” depending on which one you choose.
* **Utilities:** The bank wants to know if you can cover other expenses associated with the home that must be paid, like heat and power. Use the other side of the calculator to fill in information about your expenses that you have filled in on your budget spreadsheet previously**.** If you didn’t have a heating bill before it will typically cost about $100/month to heat a detached home and about $75/month for an attached home (townhouse/condo).
* **Property taxes**: Every home is required to pay taxes on the property. This goes to pay for services in your community like education, roads, police, fire, etc. Find the Property Tax Calculator link on the project website. Enter the address of the home you chose into the search (let it find the place as you search so it’s written correctly) and determine what the monthly or annual property taxes are for this property. Include the amount in the mortgage qualifier tool. Make sure you have the drop-down menu set properly (monthly or yearly) on the tool.
* You can leave the other types of debt (credit card, car payment, and other debt) blank as it won’t be necessary for qualifying.
* Once everything is entered into the fields on the calculator, press calculate and see if you can afford this home. If your **Gross Debt Servicing Ratio** (GDSR, this is your gross income minus your mortgage and utility costs) is over 32% of your monthly income you won’t qualify for this mortgage. If your **Total Debt Servicing Ratio** (TDSR, this is your gross income minus your mortgage, utilities, and any other debt you have like a car payment) is more than 40% of your income you won’t qualify for this mortgage. If you don’t qualify for a mortgage afterwards, then you need to search for a cheaper home and complete the setup again. If you qualify for the home, record the following information in the chart below:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **Listing Price of the Home** | **Total Mortgage Amount** | **Monthly Payment** | **GDSR %** | **GDSR Cost** | **TDSR** **%** | **TDSR Cost** |
|  |  |  |  |  |  |  |

**Record the home information here:**

Address: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Neighbourhood: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Annual Property Taxes: \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**Part 3: Calculate your Mortgage Payments**

Now that you have a house picked out that you can afford, we need to figure out how much this house will cost after you are done paying it off in 25 years. Seems like forever huh? Go back to project website and find the link for the “**Mortgage Calculator Tool**”

**Principal:** This is the amount of money you owe and pay back towards the original amount of the mortgage.

**Interest:** This is the amount of money you owe and pay back to the bank for lending you the money. It is in addition to the amount that the bank lent you. For example, if the bank lent you $300,000 you might pay them $400,000 with the principal and interest combined over the 25 years it took you to pay them back.

A. Enter in the same information from the mortgage qualifier tool you used previously (ignore the prepayment calculator on the other side now). Click calculate and record the information in the table below:

|  |  |  |
| --- | --- | --- |
|  | **Term (5 years)** | **Amortization(25 years)** |
| **Number of Payments** |  |  |
| **Mortgage Payment** |  |  |
| **Principal Payment** |  |  |
| **Interest Payment** |  |  |
| **Total Cost** |  |  |

B. Lastly, return to the “Mortgage” tab in the budget spreadsheet and enter in the new data based on you buying a house. Don’t forget to add Property taxes (divide the annual tax by 12 to get your monthly tax if necessary) and increase Natural Gas and Electricity costs as indicated earlier in the project.

C. Now compare your two spreadsheets (Rental and Mortgage). What do you notice? Fill in some pros and cons for renting and owning a home in the charts below. Which would be a better option for your future? Explain why in your final decision.

**RENTING VS OWNING A PROPERTY**

|  |
| --- |
| **Renting** |
| **Pros** | **Cons** |
|  |  |

|  |
| --- |
| **Owning** |
| **Pros** | **Cons** |
|  |  |

**Final Decision On Which Option You Would Choose And Why:** \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_