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Loan can include the reno
Lenders recognize value of spruce-up

April 30, 2007

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CANADIAN PRESS

House shoppers on a tight budget may be faced with the realization that the only properties that they can afford are, to put it gently, something only the Munsters could love – dirty, broken and dismally out-of-date.

With a little bit of sprucing up, however, that fixer-upper can become not only a comfortable place to live but a more valuable asset.

One option to consider is the "purchase-plus-improvement" type of mortgage, which allows the qualified purchaser to borrow additional money from the mortgage lender to pay for those renovations.

With this type of mortgage, a lender is willing to take into account the improvements made by the new owner and give credit based on the increased value of the property, up to 10 per cent of the purchase price.

For example, a house that costs \$200,000 to buy would be eligible for a mortgage based on a property valued at up to \$220,000 – provided the borrower meets the right criteria.

Rob Regan-Pollock, an independent Invis mortgage broker in Vancouver, says this is an option that may appeal for buyers shopping for a first home – especially in a hot market where modestly priced houses get snapped up quickly.

A purchase-plus-improvement mortgage can give such a buyer more ammunition in a competitive real-estate market, so they don't have to settle for something that's not right for them, he says.

"If they like the location and the property has good bones, they can take the 10 per cent additional value that the purchase-plus-improvement plans allows, so that they can put in cosmetic renovations," Regan-Pollock says.

By cosmetic, Regan-Pollock means paint, new carpeting, perhaps new bathroom fixtures or kitchen cabinetry rather than a major job that entails structural changes.

"Spruce it up, so they feel like they're getting a customized living arrangement, without having to find a new home per se."

Mortgage planners or mortgage brokers can help consumers' comfort level and explore the different financing options available to them.

Lenders look at four factors when determining how much a consumer can borrow for their mortgage: the applicants' income, their credit history, the down payment they have available and their net worth.

The lender will also assess the market potential for reselling the home, in case the borrower defaults and the property must be sold to cover the debt.

With the purchase-plus-improvement type of mortgage, the lender recognizes that the resale value of the house can be increased by making a few well-chosen renovations.

In other words, prove to the lender's satisfaction with documentation and an inspection that you've spent \$20,000 to renovate that \$200,000 house and the size of the mortgage can be increased proportionately.

"That's the nice thing. They're willing to do dollar-for-dollar on the improvement that you're planning to put into the property," Regan-Pollock says.

But there are a few catches.

For instance, no matter how you slice it, the buyer is taking on a heavier debt load, and that can have repercussions for the fees they must pay and the amount that lenders will put toward the purchase.

Buyers who can't afford a down payment equal to at least 25 per cent of the purchase price must pay for mortgage insurance, available through Canada Mortgage and Housing Corp., which is a Crown corporation, and Genworth Financial Canada, a private-sector alternative.

These insurers protect lenders from a borrower who defaults on mortgage payments.

A smaller down payment on the home could bump up the cost of the mortgage insurance premium.

Regan-Pollock suggests that buyers get a pre-approved mortgage before putting an offer on a house, so they know how much they can afford.

Another hurdle that buyers should note when it comes to a purchase-plus-improvement mortgage is that the mortgage lenders don't provide the fix-up money up front.

"They'll basically refund it to the client after the renos are done."

For buyers with limited financial resources of their own, that can also be a challenge, Regan-Pollock admits.

Sometimes that involves getting a helping hand from family, who can pay some of the up-front costs.

In other cases, home improvement retailers or contractors may be willing to extend credit and provide time for the homeowners to pay for the materials or work supplied by them.