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UNDERSTANDING THE DIFFERENCE BETWEEN A DEPOSIT AND DOWN PAYMENT



Thanks to the decline in mortgage rates and the perks of working remotely, a large number of young Canadians have bought homes since the start of the pandemic.

While some are familiar with the homebuying process, others are often unaware of the difference between a deposit and a down payment. Both can help you secure a home, but they have different purposes and requirements.

DEPOSIT VS. DOWN PAYMENT

A deposit is the amount of money that you attach to your bidding offer for the purchase of the home. If your offer is accepted, the deposit is then paid upfront. A deposit helps signal to the seller that you are serious and acts as a form of security for your offer. When a seller accepts your offer, the deposit you paid is kept by the seller's realtor in a trust account. In Ontario, homebuying deposits provided to the seller's brokerage are protected by the Real Estate Council of Ontario.

A down payment, on the other hand, is the sum of money you have to pay upfront on the sale price to close the deal while the rest of the purchase amount is covered by the mortgage you obtain. A down payment is usually between 5% and 20% of the final purchase value of the house. A key difference between the deposit and down payment is their purpose in securing the confidence of the seller and the mortgage lender, respectively, about your financial ability to own a home. While a deposit tells the seller that you are determined to purchase the property, a down payment tells the bank about your capability to handle the mortgage expenses. In other words, a down payment is necessary to secure a mortgage from the bank, whereas a deposit is optional.

RISKS ASSOCIATED WITH DEPOSITS

One of the most important things to know about a deposit when buying a home is that it's not returnable. It effectively becomes a part of the down payment and is subtracted from the final purchase price of the house.

This means that a homebuyer could lose their deposit if they decide to walk away from the purchase or are unable to secure a mortgage. However, by adding a "Subject to Financing clause" in the Purchase and Sales Agreement, a homebuyer can get their deposit back if their mortgage is not approved by the lender within a stipulated time.

HOW MUCH SHOULD MY DEPOSIT AND DOWN PAYMENT BE?

In Ontario, it's not mandatory to pay a deposit for securing your offer. However, it might be difficult to get your offer accepted by the seller without a deposit amount. Often, the buyer and seller agree upon a certain amount for the deposit, generally 5% of the final purchase price of the house.

On the other hand, a minimum down payment required to close the deal, obtain the mortgage, and buy a house can vary depending on the final purchase price. In Canada, homebuyers need a minimum down payment of 5% when buying a house priced at \$500,000 or less. For purchasing a house that costs between \$500,000 to \$999,999, you need to pay a down payment of 5% on the first \$500,000 of the purchase price and 10% on the remaining price. However, if you're buying a home worth over \$1 million, you must pay a 20% down payment.

If you decide to pay a down payment that is less than 20% of the final purchase price, then you will be required to carry CMHC's mortgage loan insurance. And no matter whether you put down 20% or less, you still need to pass the mortgage stress test, which is a tool lenders use to determine if you could handle mortgage payments at either the benchmark rate of 5.25% or the interest rate you're being offered plus 2% — whichever happens to be higher.

Want to learn more about the homebuying process? Check out our first-time homebuyer's guide.



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