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It's best not to combine mortgage, line of credit

Beware of loans tied to 'real' mortgage

After Nathaniel and Danielle signed a contract to buy their Toronto dream home for $450,000, they contacted a mortgage officer at their bank to arrange financing. Their down payment of $115,000 represented more than 25 per cent of the purchase price, and they applied for a conventional first mortgage of $335,000.

At least, that's what they thought they were getting. In addition to the underlying mortgage loan, however, the bank representative talked them into taking a line of credit, which they could draw on at any time in the future if they needed to borrow more than the $335,000 mortgage.

The mind-numbing agreement that the banker had them sign contains 29 pages of small print that would cure even the most stubborn case of insomnia.

In essence the agreement states that their total borrowing from the bank consists of a secured line of credit piggybacked on top of the underlying "real" mortgage of $335,000 which was advanced on closing. Many banks try to sell this type of credit facility to homebuyers whether they ask for it or not. Lenders call these programs by different names, such as a home equity line of credit, Homeline Loan, or re-advanceable mortgage.

The turgid loan agreements specify that the homeowners can borrow additional funds from their bank up to a stated percentage of the home's value from time to time. In addition, as the mortgage balance is reduced over time, the lender may "re-advance" (or reloan) the amount of the principal reduction as an additional loan.

As it was explained to Nathaniel and Danielle, it sounded reasonable, so they signed on the dotted line. Unfortunately, their mortgage agent did not bring to their attention a clause buried in the agreement which reads, "To accommodate your future borrowing needs and at your request, we may register the mortgage in an amount that exceeds the amount of your (home equity loan limit.)"

When they showed up in my office and saw the mortgage document written up for the full $450,000 credit limit, they refused to sign.

I explained that even though the mortgage amount was higher than what they were actually borrowing, they would never have to repay more than the bank actually loaned them. Still unhappy, the clients and I spent more than an hour on the phone with various bank officials trying to unwind the line of credit or get an explanation of why the advance disclosure was inadequate.

With less than a day to go until closing, Nathaniel and Danielle reluctantly signed the $450,000 mortgage, vowing never to do business with their bank again.

Unfortunately, this was not an isolated incident. It has been repeated over and over in my practice, and in the law practices of a number of my lawyer colleagues.

My objection to what some have said is lender overselling of products or services not requested by borrowers is that consumers are not always given adequate disclosure that the registered mortgage amount will be considerably more than the underlying loan in order to secure potential future borrowing.

As well, the registration of a mortgage in the full amount of the purchase price makes it difficult to obtain a line of credit from another institution at a later date, since the property equity has been "eaten up" by the double-barrelled first mortgage. In effect, the borrowers may be locked into using the original lender for a future line of credit, even if they can get a better rate at another institution.

My advice to homebuyers is this: If you are just applying for a basic mortgage loan, don't combine it with a line of credit that you might want at some time in the future. Leave your options open. And always obtain, in advance, a clear written statement of the total amount of the mortgage loan that will be registered on title.

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