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It Matters Where Your Down Payment Comes From

The source of your down payment says a lot about the strength of your mortgage application

When people are applying with me for a mortgage and I ask them where their down payment is coming from, they often give me a confused look. They don't understand why their lender would care where their down payment comes from. After all, a down payment is a down payment. Who cares where it comes from? Actually, it matters a great deal where your down payment comes from.

The source of your down payment says a lot about the strength of your mortgage application. For example, if you have been able to save $50,000 for a down payment, it says something about how you handle money. All else being equal, a mortgage application with a down payment that comes from your savings is stronger than an application with a down payment that is a gift from a family member.

Lending institutions will ask to see proof of your down payment. If your down payment is from your savings, you will need to provide either three-month bank statements or copies of investment certificates. If the down payment is a gift from a family member, a gift letter will need to be provided with the donors contact information.

In some cases it is a requirement of the mortgage that the down payment be from the borrower's own resources. For example, there is a mortgage product available for self employed people in Canada where proof of income is not required, but it is a condition of the mortgage that the down payment — which must be at least five per cent of the purchase price — come from the borrower's own resources. I guess they figure that if they are going to loan you that much money without proof of income, you should at least be able to show that you've been able to save the down payment!

Sometimes, people want to borrow their down payment. Why would anyone want to borrow funds for a down payment? The main reason would be to avoid insurance premiums. In Canada, when your down payment is less than 20 per cent of the purchase price, you must pay mortgage insurance premiums. Mortgage insurance premiums normally range between one and three per cent of the mortgage amount. By increasing your down payment, you can reduce or avoid the insurance premium.

The disadvantage of borrowing funds for a down payment is that your ongoing monthly cost to service all your debts may become onerous. On a line of credit most institutions require three per cent of the outstanding balance to be repaid monthly. It's usually not worth borrowing your down payment but there are exceptions. I recently prequalified a buyer who had an unsecured credit line at prime (at the time of writing this article the prime rate is four per cent). By drawing $50,000 on her line of credit she would save approximately $10,000 in insurance premiums. Since the rate on the credit line was attractive and since the line of credit payments were interest only, in her case it made sense. CL