

Peter Kinch

MORTGAGE TEAM

Our goal is to help you achieve yours

FINANCING YOUR HOME RENOVATIONS

As a result of the ever-increasing value in home prices, many Canadians find themselves sitting on an unprecedented amount of equity in their homes. Some are using this equity to help afford a larger home. Some are empty-nesters looking to downsize to meet new lifestyle needs, but a record number of Canadians are saying to themselves, 'I like where I live, but I could sure use a new kitchen (or bathroom, or media room, etc...)'! For the majority of these individuals, it is easier (and at times less costly) to re-work what they already have than to go through the hassle of trying to buy a new house to find what they really want.

So let's say you've concluded that a home renovation is right for you. The next step is to ask yourself, 'How am I going to pay for it?' If you were debating between renovating and moving, then you were likely willing to take on a newer, more expensive mortgage. If you renovate instead, you could take advantage of the equity that has built up in your home as a source for financing the home improvements. Does this mean you have to re-finance and get a new mortgage to access that untapped equity? Not exactly – you will have to re-finance your home, but instead of getting a new mortgage you may want to consider using a Line of Credit (LOC).

What's the difference between refinancing with a mortgage and a LOC?

A lot of people don't realize it, but there is a significant difference between refinancing for a mortgage and a LOC. When you refinance your house and get a new mortgage to access your latent equity, you will have to pay principal and interest payments on the entire amount of the new

mortgage from day one – regardless of whether you use it all or not. Let's look at an example of a couple who has an \$800,000 house. Let's suppose the current mortgage is \$300,000 and they are looking to spend about \$200,000 to do a major renovation. If they were to use a new mortgage to access the additional \$200,000, their new mortgage would be \$500,000. If they are like most couples, a renovation that size would happen over a period of time so they wouldn't actually need the entire \$200,000 right away. However, if they had arranged a new mortgage, they would have to start paying principal and interest payments on the entire amount of the new \$500,000 mortgage from the first day that the funds were advanced. This process could be further complicated by the fact that, in order to get an advantageous rate, they would want the new funds to be added onto the first mortgage instead of being placed as a more expensive second mortgage. This may result in a payout penalty on the first mortgage if it is cancelled and replaced by a new one.

Alternatively, let's consider the use of a LOC instead. If the couple in our example qualified for the payments, lenders will offer up to 80% of the value of their home in the form of a Home Equity Line of Credit (anything beyond 80% would need to be insured). 80% of an \$800,000 home would represent a loan amount of \$640,000. If, in our example, this were set up in the form of a LOC instead of a mortgage, the lender would arrange a new Line of Credit to go behind the existing first mortgage. The existing mortgage of \$300,000 would stay intact (with no penalty) and a LOC of \$340,000 would be registered behind it at the bank's Prime rate. The key with a LOC is that regardless of how much the line is set up for – you only pay for the amount advanced at the

time it is advanced – and, if you choose to, you can pay interest only. In other words, our sample couple could have a LOC established in the amount of \$340,000 and only need \$50,000 the first month. They would only be obligated to make 'Interest Only' payments on the \$50,000. This would be significantly less expensive than the Principal and Interest payments they would have had to make if they had refinanced into a new mortgage instead. Ah, but you say, why set up the LOC for \$340,000 when they don't need that much money? Well, here's the beauty of a LOC vs. a Mortgage – with the LOC, once the line is set up, it represents the amount of money you have access to, but you only pay interest on the actual amount you advance. And remember, unlike a mortgage, you can pay off a LOC at any point with no pre-payment penalties.

As for the excess amount of funds that you don't need today – well, as long as you can be disciplined enough not to use it to subsidize lifestyle – creating a Line of Credit today to help you access funds for the future is not a bad idea. Remember, you only pay interest on the amount of funds you advance, so if you don't use it – you don't pay for it. But since you are going through the process of setting up the LOC in the first place – which means you will incur certain fees such as legal and appraisal (the same costs involved with setting up a mortgage) – you may as well qualify for the maximum. That way, if an investment opportunity arises in the future, or you decide to do another renovation, or even if you simply need a 'rainy-day' fund, you always know you have it in place. And again, if you don't use it – you don't have to pay for it.

If you decide a home renovation is in your plans and you want to put that hard earned equity to work, make sure you arrange the financing that's right for you. Remember, it makes no sense to pay interest on money you're not using.



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