

## Historically Low Rates - Should I switch?

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With rates being so low, the question on a lot of minds these days is whether it is worthwhile trying to get out of your current mortgage and converting into one with a lower interest rate. I wish I could give you an easy answer and say yes - but unfortunately, it is a case-by-case situation.

Yes, we are in a very low rate environment and yes you can, in many instances, lower your mortgage payments significantly by converting your current mortgage, but you will also be faced with a penalty to do so.

### Why do the banks charge Pre-payment Penalties?

Pre-payment penalties are created by banks to recuperate the money they expect to lose by re-negotiating your contract. The key point that borrowers have to remember is that when you enter into a mortgage, you are essentially entering into a 'contract'. You are contractually obligating yourself to pay X-\$'s a month over the next X-# of years. In essence, your mortgage payment contract represents an 'annuity' or payment stream to a bank which they can in turn sell to a third party investor.

When you suddenly come along and decide that you want to renegotiate that contract, the bank has to calculate how much they stand to lose in the process and as such they create a pre-payment penalty to offset that loss.

The pre-payment penalty can range from three months interest to a much higher amount based on what is called the 'Interest Rate Differential' or 'IRD'.

The IRD can be a complicated calculation and differs from bank to bank, but in essence it simply calculates the differential between what you were going to pay if you continued with your current mortgage vs. what the bank can re-sell that money for in the current market.

#### For example:

If you have 3 years left on your current 5 yr mortgage at 5.79% and you find a better deal with a different lender and cancel your mortgage, your current bank will take the balance of the money owing, determine what rate they can sell that for in today's market (ie 3 yr term at 3.75%) and then calculate your penalty based on the 'deemed lost revenue'. Again, this will be done on a case-by-case basis and in some circumstances where there is a large mortgage with a lot of time left on it - the IRD penalty can be significant.

### If I have a large penalty is it worth switching?

In many instances it is still worth paying the penalty because the lower rates create such a savings, but again, it is case-by-case. Although there will definitely be situations where it makes no sense to pay a high penalty, a lot of people don't





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realize that you can capitalize your penalty into your new mortgage. Let's say for example, the penalty on your existing mortgage is \$15,000 and you don't have that kind of cash kicking around today. In many cases, the rates are so low that even if you increased your mortgage by another \$15,000 (to cover the cost of the penalty), both your monthly payments and the balance at the end of the term would be lower. The only caution is that if you switch lenders and change the actual \$ amount on the loan, you may have to have the mortgage re-registered at Land Titles and that will trigger legal fees. But again, it may still be worth it.

## What do I do next?

It is well worth doing an analysis of your current mortgage in order to determine if you are in a position to consider switching. The first step is to call your current lender and ask them 'How much would the penalty be if I sold my house and paid off the mortgage today?'

All our office needs in order to do an analysis for you is:

- The amount of your penalty
- The current balance of your mortgage
- The current interest rate
- The current term and how much time is remaining on that term
- Current monthly payments
- Balance owing at the end of your current term

Give us a call or send us an email with the above information and we'd be more than happy to provide a quick analysis of your options at no cost. You never know - it could save you a lot of money.

Email: [clientcare@peterkinch.com](mailto:clientcare@peterkinch.com)

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