Protecting your biggest investment

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PERSONAL BAILOUT

MORTGAGE REFINANCING

TIPS ON RIDING OUT THE RECESSION

Interest rates have fallen sharply in the past six months, prompting questions about refinancing.

How much will you save if you "break" a closed mortgage to get a lower rate?

If you're a tough negotiator, or have a mortgage broker on your side, you can get a five-year mortgage at 3.55 to 3.75 per cent — down from 5.75 per cent last November.

Here's a guide to extricating yourself from a fixed mortgage without losing the savings to penalty charges.

- Read your mortgage contract. It spells out the conditions for getting out early before the end of the term and the charges paid to compensate the lender against losses.
- Find out what kind of penalty you face. In most mortgages, you have to pay three months' interest on your current balance or the interest rate differential (IRD), whichever is greater.
- Check out the IRD. It's based on the amount you're prepaying and an interest rate that equals the difference between your original rate and the rate the lender can charge

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Calculate penalties and savings on the web

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today when relending the funds for the remaining term of the mortgage.

- Ask the lender what is the original rate used to calculate the IRD. Is it the posted rate or the discounted rate? Using the posted rate results in a wider gap and a higher penalty.
- Estimate the penalty. There's a link to an online calculator at www.ellenroseman.com (search for Mortgage Penalty).

Suppose you have a balance of $200,000 and 30 months left of a five-year mortgage term. The original rate is 5.5 per cent and the current rate for a comparable term is 3.5 per cent.

The calculator shows that the three months' interest penalty is about $2,750, while the IRD penalty is about $12,000. (This is a rough guide.)

- Estimate the savings, using a mortgage savings calculator at Industry Canada's website, developed by finance professor Moshe Milevsky at York University. (Go to www.ic.gc.ca, the Learn More A-Z index, and look under M.)

Prepayments will reduce your mortgage, without paying refinance penalty

Suppose you pay a $12,000 IRD penalty, which is added to the mortgage principal when you refinance.

You get a three-year rate of 3.5 per cent, but keep your monthly payments the same.

The calculator shows that, by refinancing, you can pay off the mortgage in 15.17 years and save 23 months of payments.

- Find out about prepayment privileges. How much of the outstanding balance can you prepay each year and when? Make the most prepayments you are allowed, because they reduce the amount on which IRD is calculated.
- Ask about an unsecured line of credit for prepayments. It will be repaid when you refinance the mortgage with a different lender or sell your house.
- Ask about portability. Can you take your existing mortgage with you when selling a home and buying another one? This can be less costly than breaking the mortgage when you sell.
- Negotiate a longer portability period. Instead of three to four months, can you get six months? How about a year?
- Always remember that an IRD penalty is a moving target. When interest rates fall, the penalty grows.
- Recognize that a lender can quote you a penalty today and raise the amount substantially by the time the mortgage is refinanced or the house sale closes. Act quickly to keep the IRD low.
- Think about making prepayments to reduce your mortgage instead of paying a penalty to refinance. For many borrowers, this is the smartest decision.

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