Time to rethink your mortgage

Some are refinancing not for the savings, but rather to lock in today's low rates for five years

By Fiona Anderson, Vancouver Sun March 5, 2009

Low mortgage rates have buyers knocking on lenders' doors.

Photograph by: Glenn Baglo, Vancouver Sun files

Have a fixed-rate mortgage at 4.5 per cent or higher? Then you should be refinancing, says Steve Moffitt, senior mortgage consultant with Equimac Mortgage Centre in Vancouver.

"There's never been a better opportunity historically, never, for doing a refinancing, " he adds.

If only it were that simple.

In fact, determining whether you should refinance or not depends largely on the penalty you will pay to get out of your current mortgage, and the amount of money you could save with a new one.

The first part of the equation — the penalty — is not easy to calculate.

Most fixed-term mortgages charge the greater of three months' interest or what's called the "interest differential." This latter amount is the difference between the interest you would have paid for the remainder of your mortgage term and the amount the bank can earn lending out the money now.

So if you have a five-year mortgage at 5.25 per cent with three years left to go, and the bank's current three-year rate is 4.5 per cent, you'll have to pay the difference.

Often the amount of the penalty is about the same as the savings to the borrower, "so it's a wash," says Feisal Panjwani, a senior mortgage consultant with Invis.

Moffitt's magic number of 4.5 per cent uses the penalty of three months' interest, which he says he sees often.

But which penalty will apply really depends on the particular mortgage. So both Panjwani and Moffitt encourage people to ask their mortgage professional to crunch the numbers for them.

The current best five-year fixed-rate available is 4.19 per cent for most borrowers, Panjwani says. And he believes the rate could go as low as 3.99 per cent in the near future. The best variable rate is the prime lending rate set by the banks plus 0.8 percentage points, which today translates into 3.3 per cent.

With rates that low, everyone who currently is paying 4.5 per cent or higher should probably do the math because there could be thousands of dollars in savings.

One way to save may be switching from a fixed- to a variable-rate mortgage, because with the variable rate so low, the savings are more likely to outpace the penalty costs, Panjwani says. But because the rate does change, "that's risky," he adds.

Some people are refinancing their mortgages not for the savings but rather to lock in today's low rates for five years, Panjwani says. For example, if someone has three years left in their mortgage term, they may not save any money in the first three years of the new mortgage because of the penalty. But they have guaranteed today's rate for two years after that.

Keep in mind, however, that there are costs associated with refinancing that have to be added to the equation, Panjwani says.

One group of borrowers who need not worry about refinancing are those who were already in variable-rate mortgages. In the past, those rates were calculated as prime less a premium, and some outstanding mortgages chop off as much as 0.9 percentage points. With prime now at 2.5

per cent, those people are paying 1.6-per-cent interest. That number can't be beat, especially considering prime could go down even further.

"Anyone on a variable floating below prime, I would say those people should probably hang onto that mortgage," Panjwani says.

The low mortgage rates also have buyers knocking on lenders' doors.

Last month, 40 per cent of Panjwani's business came from purchasers rather than those looking to refinance. While the split is normally 50-50 between the two, in the last few months only about 20 per cent were purchases, he says.

Carolyn Heaney, an area manager with BMO Bank of Montreal's business development group, says her bank has seen a lot more first-time homebuyers.

The combination of low mortgage rates and lower prices means people who have wanted to live in a particular area but couldn't afford it now can, she says.

At the current variable mortgage rate, a $200,000 mortgage with a 25-year amortization, would have payments of about $980 a month, she says. At a fixed rate of 4.39 per cent, the payments would be about $1,100.

"So it's very affordable for people to get into the market," Heaney says.