

Refinance - Debt Consolidation (Part II)

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What is home equity?

The difference between your home's market value and the mortgage on the home is your home equity.

Example:

- Market Value: \$500,000
- Mortgage Amount: \$300,000
- Equity in Home \$200,000

The market value of your home is depending on the market, it is not your purchase price. A realtor or an appraiser can tell you how much your property worth. Their criteria are usually comparison of the sold homes in the neighbourhood in the last few months.

How do you build Equity in your home?

You put a big down payment when you purchase. Prices go up and you create equity (remember the market value not purchase price), although this does not happen always. The last method is over the years you have paid a portion of the principal (monthly payment or lump sum) of your mortgage to the banks. Every single monthly payments of your mortgage payment consist of principal and interest payment.

How can the equity be used?

Over the years your may accumulate a large debt. The debt can be any type like Line of Credit, Credit Cards, Student Loan, car loan, consolidation loan, etc. These loans usually have high interest rate ranging from 5% to 20%. You can pay out the other loans with the mortgage and doing a debt consolidation. This way there are 2 advantages.

- You replace high interest rate debt payments with low interest rate of mortgage
- You make just one payment a month with your mortgage payment rather than many payments.

Example:

Loan Type	Rate	Amount of Loan	Monthly Payment
Student Loan	8%	\$20,000	\$200
Car loan	5%	\$30,000	\$500
VISA	19.9%	\$10,000	\$300
MC	19.9%	\$10,000	\$300
Total		\$70,000	\$1300

So your total debt is \$70,000 and your total payments is \$1,300 just on your debts.

Now we assume you have the current mortgage at:

- Market Value: \$500,000
- Mortgage Amount: \$300,000
- Equity in Home \$200,000
- Amortization 25 Years
- 5 Years Fix Rate 4.00%
- Payment \$1,578

Your total payments per month is the sum of your mortgage payment and your debt monthly payment \$2,878 ($=\$1,578 + \$1,300$).

If you add the 70,000 to your mortgage the total mortgage will increase to \$370,000 and your payment only increase \$368.

- Market Value \$500,000
- Mortgage Amount \$370,000
- Amortization 25 Years
- 5 Years Fix Rate 4.00%
- Payment \$1,946

This way the \$70,000 debt is consolidated into your mortgage, your total payments is now just your mortgage payments which is 1946 and you have savings of 368 per month.

Another good method of saving is if you can get a variable rate mortgage or a mortgage with lower fixed interest rate than what you have now. This way your savings would be much higher and your monthly payments of much lower.

- Market Value \$500,000
- Mortgage Amount \$370,000
- Amortization 25 Years
- 5 Years Variable Rate 2.00%

- Payment \$1,566

your total payments is now just your mortgage payments which is \$1,566. Remember your total payments per month previously was the sum of your mortgage payment and your debt monthly payment \$2,878 (= \$1,578 + \$1,300). Now your saving is \$1312. Is not this just wonderful!

How much can you Refinance?

When you refinance usually the banks/lenders finance up to 90% or 85% of the price of the market value (appraised value) of the house. This also depends on your qualifying for that amount of mortgage.

So in the example above the maximum mortgage considering 85% would be :

- Market Value: \$500,000
- Current Mortgage Amount: \$300,000
- New Mortgage (85% of Market Value) \$425,000

Conclusion

When you debt consolidate it gives you a financial freedom by reducing all your debts to just one mortgage payment. You can save more during refinance for debt consolidation especially when you also reduce the rate meanwhile.

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