

## Title: "Solution for Savings, being debt free and Investment – The Refinance"

### Refinance – Savings by Lower rate and payment (Part I)

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The refinance is a term in mortgage and finance industry which applies to when you change the terms of the current mortgage on your home.

Usually the reason why you should do it is one of the following or a combination of them:

1. Lower rate and payment
2. Debt Consolidation
3. Equity Take out

Before describing the 3 items above it is good to know how the mortgage payment is calculated. There are 2 factors to calculate your mortgage payment:

1. Interest Rate: Interest Rate bank charges on your mortgage will directly affect you mortgage payments.

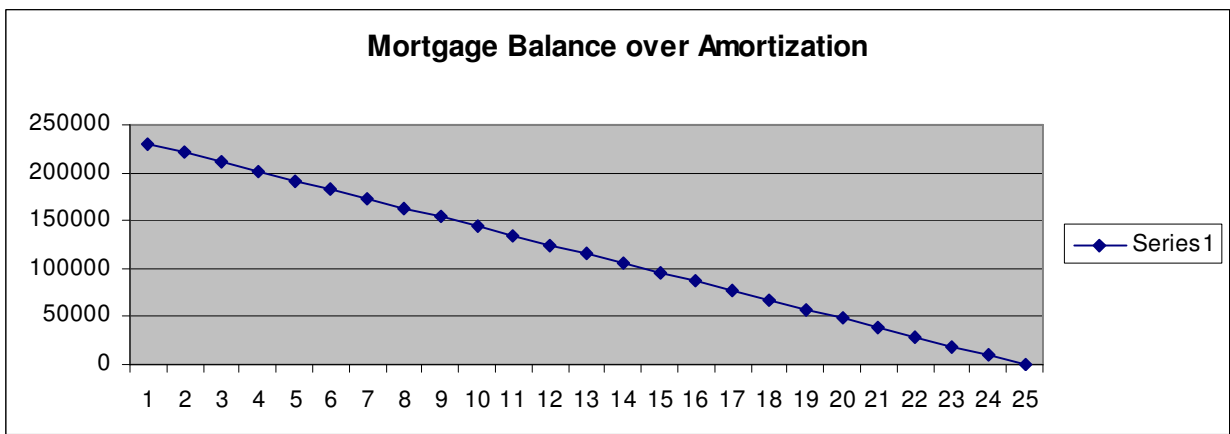
Also the interest rate can be fixed for the term of the mortgage (fixed Rate Mortgage), or can be variable (variable Rate Mortgage). With the Fixed rate mortgage

the payments are fixed over the term of the mortgage and on Variable Rate mortgage the payments can vary based on the rate change.

2. Amortization: The number of years it takes to pay off your mortgage also determines your monthly payment.

Fix Rate Mortgage Example:

Purchase Price:	\$300,000
Down Payment:	\$60,000
Mortgage Amount	\$240,000
Amortization	25 Years
5 Years Fix Rate	5.5%
Payment	\$1,465



## Term of a Mortgage:

- Term of the mortgage is the length of your contract with the bank.
- Usually the terms are 1, 2, 3, 4, 5, 7, 10 Years, The 5 year term is usually the optimum and is considered mostly in the mortgages. The default rate when people are talking about mortgage is for a 5 year term.

## How to reduce the Mortgage payments?

**Longer Amortization** - The maximum amortization offered now is 35 Years. Average is between 25 and 35.

Advantage: the longer your amortization is it the Lower your monthly payment becomes.

Disadvantage: You end up paying more interest over longer period of time.

Good choice (use longer amortization and pay as much as possible with prepayments)

Prepayment is increased monthly payments or paying your principal partially. This is allowed amount with no penalty.

## Changing to Longer Amortization:

Purchase Price:	\$300,000
Down Payment:	\$60,000
Mortgage Amount	\$240,000
Amortization	35 Years
5 Years Fix Rate	5.5%
Payment	\$1,279

Payment was \$1,465 for 25 years AM. The difference is 186 per month.

Lowering the Rate - If the new mortgage rate is lower you save by paying less monthly payments and less interest over the term of mortgage.

## Lowered Interest Mortgage Example:

- Purchase Price: \$300,000
- Down Payment: \$60,000
- Mortgage Amount \$240,000
- Amortization 25 Years
- 5 Years Fix Rate 4.00%

- Payment \$1,262

In this example the mortgage payments has been reduced from \$1,465 to \$1,262 which is \$203 savings per month. In the course of 5 year term the total saving in interest portion is also \$17,270. This is quite substantial savings. The balance of the mortgage after the 5 years would be \$5,120 lower in case of 4% mortgage rate which is another savings. So your total savings is \$22,390 (=17,270+5,120). Along with \$203 less monthly payment per month you will have made.

Lowered Interest Mortgage Example II:

- Purchase Price: \$300,000
- Down Payment: \$60,000
- Mortgage Amount \$240,000
- Amortization 25 Years
- 5 Years Variable Rate 2.00%
- Payment \$1,016

In this example the mortgage payments has been reduced from \$1,465 to \$1,016 which is \$449 savings per month. In the course of 5 year term the total saving in interest portion is also \$39,921. This is quite substantial savings. The balance of the mortgage after the 5 years would be \$13,000 lower in case of 2% mortgage rate which is another savings. So your total savings is \$52,921 (=39,921+13,000). Along with \$449 less monthly payment per month you will have made.

As you may have noticed in variable rate your saving is much higher. The only drawback is variable rate mortgage does not have a fix rate and payment over he term of 5 years but on average you still are in better position comparing to fixed rate and payment.

The other negative point when doing the “refinance” is the penalty involved.

Penalty Calculation:

- 3 months interest
- IRD (interest rate differential)

The greater of the 2 (IRD and 3 Months interest) is the penalty when it is a fixed closed mortgage, however in case of variable rate mortgage it is always 3 months interest. The 3 months penalty is a factor of current rate of your mortgage and your balance. On an IRD penalty it depends on your contract rate, the current rate of the mortgage for the remaining term, the mortgage balance and the remaining months of your current mortgage term.

Penalty Example 3 months Interest:

- Balance of Mortgage after 2 years: \$230,456
- 5 Years Fix Rate 5.5%
- Payment \$1,465
- 3 months interest \$3,169

Penalty Example IRD:

- Balance of Mortgage after 2 years \$230,456
- Contract Rate(5 Yrs) 5.5%
- Payment \$1,465
- Current Rate(3Yrs) 4.00%
- IRD \$10,370

There are different ways banks calculate the IRD. You better off ask your bank how much is your penalty rather than trying to calculate it by yourself.

Compare the 3 months interest penalty (\$3,169) vs. the IRD penalty (\$ 10,370). Usually the 3 months interest penalty is much lower than the IRD penalty.

**Conclusion** is that usually it is still worth and you save and you benefit to refinance/Switch when the rates go low.

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