Financial Consumer Agency of Canada
Agence de la consommation en matière financière du Canada

RENEWING AND RENEGOTIATING YOUR MORTGAGE

Smart mortgage decisions start here

Financial Consumer Agency of Canada
IT PAYS TO KNOW.

Canada

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About Financial Consumer Agency of Canada (FCAC)

With educational materials and interactive tools, the Financial Consumer Agency of Canada (FCAC) provides objective information about financial products and services to help Canadians increase their financial knowledge and confidence in managing their personal finances. FCAC informs consumers about their rights and responsibilities when dealing with banks and federally regulated trust, loan and insurance companies. FCAC also makes sure that federally regulated financial institutions, payment card network operators and external complaints bodies comply with legislation and industry commitments intended to protect consumers.

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OVERVIEW

When you bought your home, you probably signed a mortgage agreement that remains in effect for a certain period, called the term. When your mortgage term comes to an end, you will have to either pay off your mortgage or renew it for another term. This is a good opportunity to reassess what you need in a mortgage and to look for mortgage options that better fit your needs today.

You might also think about breaking your mortgage contract before the term ends, either because your financial situation has changed or to take advantage of changes in the interest rates that are available from mortgage lenders. This is called renegotiating your mortgage. Knowing what questions to ask can help you find the best mortgage for you.

THE RENEWAL PROCESS

What to expect from your lender

If your mortgage agreement is with a federally regulated financial institution such as a bank, **the lender must provide you with a renewal statement at least 21 days before the end of the existing term**. This statement must contain the same type of information that is in your current mortgage agreement, such as the interest rate, payment frequency, term, and effective date. It may be combined with a mortgage renewal agreement.

If your lender decides not to renew your mortgage, it must notify you at least 21 days before the end of your term.

When to start shopping around

Approximately four months before the end of your mortgage term, you should contact various lenders and mortgage brokers to find a new mortgage with the terms and conditions that best suit your needs. When you are negotiating an interest rate, ask your current lender if they can offer you even better terms and conditions than in your previous mortgage term.

Take an active approach to finding the mortage that best meets your needs. Remember that for most people, the mortgage payment is one of the biggest chunks of their household budget. Shopping around and negotiating with your current lender will save you money. On the other hand, if you don't take charge of the process, your mortgage might automatically be renewed for another term. This means that **you may not get the best interest rates and conditions that you could**.

The first step is to reassess your needs. Ask yourself the following questions to help you find the right mortgage:

- Are you satisfied with the services offered by your current lender?
- Does your household budget allow you to increase your mortgage payments so you can pay off your mortgage sooner?
- Do you want to change your payment frequency?
- Can you make prepayments?
- Do you want to consolidate other debts that have higher interest rates?
- Do you need money for a major renovation?

Financing with another lender

You do not have to renew your mortgage with the same lender. You can choose to move your mortgage to another lender if it offers you terms and conditions that suit your needs better. When you refinance your mortgage with a new mortgage lender, the new lender will process the mortgage application as if you are applying for a new mortgage.

If you decide to switch your mortgage to another lender, make sure you verify the costs of changing lenders, such as legal fees to register the new mortgage, fees to discharge the previous mortgage and other administration fees. You can ask if your new mortgage lender will pay these fees. You will also need to meet with your lawyer (notary in Quebec) to sign the mortgage agreement and confirm your identity.

Dealing with a mortgage broker

A mortgage broker is a person or organization that offers the mortgage products of several different lenders. If you decide to deal with a mortgage broker, it is important to note that the broker may not automatically check whether your current lender can offer you a better deal.

To be sure that you are getting the best offer from your current mortgage lender, contact the lender directly. It is your responsibility to compare the new offers with the offer from your current lender. If you have questions about mortgage brokers, contact your provincial government, which regulates them.

RENEGOTIATING YOUR MORTGAGE AGREEMENT: BREAKING YOUR CONTRACT

During your mortgage term, if you find that your current mortgage no longer meets your needs or interest rates go down, you may want to renegotiate your mortgage agreement – in other words, change the conditions of your current mortgage. Before you do, you need to determine whether renegotiating your mortgage is worth the potential costs, or if alternatives may better meet your needs.

Breaking your mortgage agreement

Different mortgage lenders offer different terms and conditions. If you have a closed mortgage, your financial institution may or may not allow you to break your mortgage agreement. Read your mortgage contract or contact your mortgage lender to find out.

If the financial institution does allow you to break your mortgage agreement, **they may charge you a penalty and some fees**. Your financial institution or the new lender may be willing to waive or pay part or all of these fees if you ask it to do so.

Before breaking your mortgage agreement, find out whether:

- you have to pay a penalty and what that amount is
- you have to pay an administration fee
- you have to pay legal or disbursement fees to discharge the **old** mortgage
- you have to pay legal or disbursement fees to register the **new** mortgage
- you have to repay some or all of any "cash back" you may have received when you first obtained the mortgage
- the calculation of any prepayment penalty would be based on the posted rate at the time you signed your mortgage agreement, or on a discounted rate if you negotiated one for your initial mortgage.

Penalty charges

If you have to pay a penalty to break your mortgage agreement, your mortgage agreement will describe how the penalty is calculated. It is generally linked to your mortgage interest rate and may cost thousands of dollars.

To find out how much your penalty will be, read your mortgage agreement or contact your mortgage lender. Keep in mind that the penalty can change from day to day because it is based on current market interest rates, the outstanding balance left on your mortgage, and the amount of time left on the mortgage term. However, the estimated amount that your lender gives you should be close to the penalty.

EXAMPLE: PENALTY CHARGE

Jim started with a mortgage of $100,000, amortized over 25 years, with a fixed interest rate of 7.5% for a five-year term.

- Each month, he makes a mortgage payment of $732.
- He has 36 months (3 years) left on his 60-month (5-year) term.
- He has $97,007 left to pay on his mortgage.

Jim wants to break his mortgage and take out a new mortgage contract, to benefit from the lower interest rates currently being offered. The current market mortgage rate for a 36-month (or 3-year) period is 5.5%. Jim's mortgage agreement specifies that he would pay a penalty if he wanted to re-negotiate his mortgage early. Jim needs to find out how much that penalty would be.

Jim's mortgage agreement specified that the penalty would be calculated based on the difference between his existing interest rate and the new one. **The lender calculates his penalty to be $5,820.**

When Jim is deciding whether to renegotiate his mortgage agreement and pay this penalty, he should consider:

- whether he would be better off paying the penalty required to negotiate a new mortgage term at a lower interest rate or using the money to make a lump-sum prepayment
- whether he really is going to save any money after paying the penalty
- whether interest rates are forecast to drop further during his mortgage term.

Tips on reducing penalty charges

You may be able to reduce the amount of penalty charges you have to pay by making a lump sum prepayment **before** renegotiating.

Many mortgage agreements offer prepayment options without penalty. If you can do so, you may want to prepay a portion of your mortgage before you renegotiate it. Your penalty would then be calculated on the smaller balance left to pay.

Blend-and-extend option

Some mortgage lenders may allow you to take advantage of the current lower market interest rates by extending the length of your mortgage before the end of your term. They do this by blending your old interest rate and the new term's rate. This is called the "blend-and-extend" early renewal option.

Blend-and-extend option: Calculation of new interest rate

$$\text{New interest rate} = \frac{(A \times B) + [(C \times (D - B)]}{D}$$

A: the interest rate of the existing mortgage term

Note: Some financial institutions may use the current rate that they are offering for new mortgage terms.

B: the remaining months in the existing term

C: the new interest rate

D: the number of months of the new term

EXAMPLE

Linda has an interest rate of 7.5% on her mortgage and there are 12 months left in her term. Her financial institution now offers a five-year (60-month) mortgage with an interest rate of 5.5%.

If Linda decides to extend her mortgage before the end of the term, her lender is willing to offer her a blend-and-extend option. Linda's new mortgage rate would be as follows:

Blend-and-extend calculation

$$\frac{(7.5\% \times 12 \text{ months}) + [(5.5\% \times (60 \text{ months} - 12 \text{ months})]}{60 \text{ months}}$$

$$= \frac{(7.5\% \times 12 \text{ months}) + [5.5\% \times 48 \text{ months}]}{60 \text{ months}}$$

$$= \frac{(90 + 264)\%}{60}$$

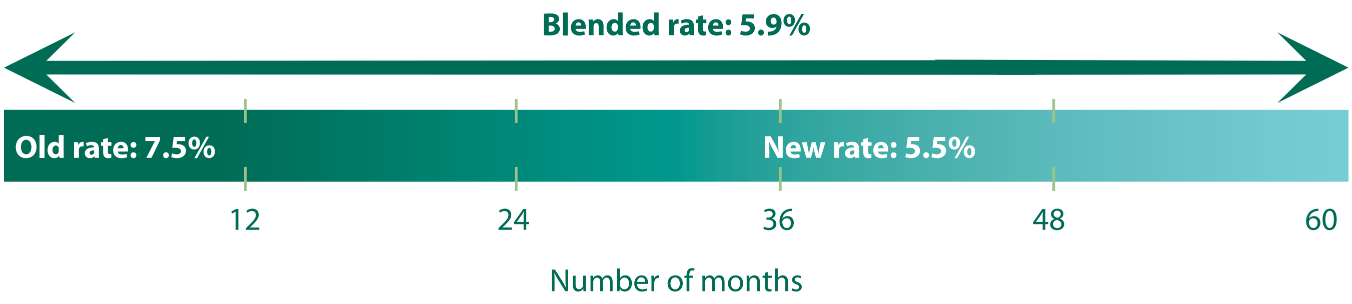
$$= \mathbf{5.9\%}$$

A = 7.5% current term interest rate

B = 12 months left on the current term

C = 5.5% available interest rate for a 5-year term

D = 60 number of months in a 5-year term



If Linda chooses the blend-and-extend option, her mortgage rate will be 5.9% for the next 60 months. She will not have to pay a penalty to benefit from the lower rate.

Linda may benefit from the blend-and-extend option if she believes that interest rates will increase substantially before the end of the term of her mortgage and she wants to "lock in" the lower rates now.

Notes:

- The preceding method of calculating the blended rate has been simplified for illustration purposes. Contact your financial institution for the exact blended rate.
- Your mortgage lender may add an administrative fee.

Weighing the benefits and risks

When interest rates fall, it may be tempting to break your existing mortgage and renegotiate a new one at a lower interest rate, or to "blend-and-extend". Before you do that, it is important to weigh the benefits and risks.

Benefits

- You get a lower rate and potentially lower payments.
- If you keep the payment the same as with your current agreement, you will be able to pay off your mortgage sooner.
- You can lock in the lower interest rate for the new term of the mortgage.

Risks

- If there is a penalty, the cost could be more than any savings that you might get.
- The interest rates may continue to go down, in which case you would not lock your new mortgage in at the lowest rate possible.

KEY POINTS TO REMEMBER

- A mortgage is probably one of the biggest financial commitments you will ever make, so it is worthwhile to do your homework.
- When you are mortgage shopping, compare the whole package offered by each lender. In addition to comparing interest rates, consider the features (such as ability to make prepayments or to increase your regular payments) and the services that are important to you.
- Remember that interest rates are often negotiable.
- Read your mortgage agreement carefully before you sign it, and ask questions about anything you don't understand.
- If you are considering renegotiating your mortgage, make sure you have complete information about any penalties and fees involved, so that you can weigh the costs and benefits before making a decision.

ABOUT THE *ABCs OF MORTGAGES* SERIES

The *ABCs of Mortgages* series explains the features and costs of mortgages. The following resources are part of the series and are available on FCAC's website at **www.fcac.gc.ca**:

Publications

- Buying Your First Home
- Paying Off Your Mortgage Faster
- Renewing and Renegotiating Your Mortgage
- Borrowing on Home Equity

Tip sheets

- Shopping Around for a Mortgage
- Buying and Maintaining a Home: Planning Your Housing Budget
- Choosing an Amortization Period: What is the Impact on Your Mortgage
- Understanding Variable Interest Rate Mortgages
- Understanding Reverse Mortgages
- Protect Yourself from Real Estate Fraud

Online tools

- Mortgage Qualifier Tool
- Mortgage Calculator Tool

Online Quiz

- Mortgage Quiz

GLOSSARY

Amortization period
The period of time it will take to pay off a mortgage in full. The most common amortization period for a new mortgage is 25 years. Not to be confused with the **term** of the mortgage.

Blended rate
An interest rate, applied to a refinanced loan, that is a combination of the interest rate of the old mortgage and the interest rate for the additional amount to be borrowed.

Cash back
An optional feature that pays you a percentage of your mortgage in cash right away, in some cases in return for a higher interest rate than you would have paid without that feature. This can help you pay for things you'll need when getting a new home, such as legal fees or even furniture.

Closed mortgage
A mortgage agreement that cannot be prepaid or changed before the end of the term. Your lender may let you make certain prepayments without penalty, but you will usually have to pay a penalty to break your mortgage agreement.

Mortgage broker
A person or organization that offers the mortgage products of different lenders.

Prepayment penalty
A fee charged to you by the lender for making a prepayment greater than the amount allowed in your mortgage agreement, or for paying off a closed mortgage before the end of the term.

Posted rate
The interest rate advertised or shown by a financial institution. Usually, financial institutions advertise their mortgage interest rates without any discounts. You may be able to negotiate a lower interest rate before you sign your mortgage agreement.

Prepayment
Payment of an additional portion or all of the principal balance before the end of your term. Lenders may charge fees when you use a prepayment option under a closed mortgage agreement.

Term
The period of time your mortgage agreement will be in effect. At the end of the term, you either pay off the mortgage in full, renew it or possibly renegotiate your mortgage agreement (for example, decrease your amortization period). Terms are generally for six months to 10 years. Not to be confused with the **amortization period**.

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