Special

Update on mortgages

Even small measures can shave away years of payments

Mortgage-free (faster)

When Laura Silverman and Zachary Nichols added up the cash they'd received as wedding gifts, they decided to use the welcome windfall as a prepayment on the mortgage for their Montreal condo. And while applying $3,000 against a $200,000 mortgage may not sound like it would have much of an impact, it was a wise move.

Particularly in the early years of a mortgage, even paying an additional $100 or $200 a year can make a meaningful difference in the total interest paid over the amortization period, says David Stafford, managing director of real estate secured lending at Scotiabank. "It's money you don't have to pay interest on every month from now until the end of the mortgage."

Many Canadians are unaware that with a standard 25-year or 30-year amortization, the amount of interest they'll pay is surprisingly close to the value of the original mortgage. "If you borrow $100,000 today at prevailing rates, you're probably going to pay back something like $160,000," explains Mr. Stafford.

It's the opposite of compound returns in an RRSP, he says. "If you borrow the money today, and two weeks from now you have your first payment, a little bit of that $100,000 is being paid back in that first payment. On that principle repayment, you've paid almost no interest – so any extra payment is all-important because it will save you about 30 years of interest on the extra amount paid."

Many homebuyers find themselves stretched financially by competing demands for their paycheques, but being mortgage-free faster is still not out of the question, says Mr. Stafford. Applying a few pain-free strategies, such as making 26 payments each year with accelerated bi-weekly payments rather than 24, or increasing payments by just one or two per cent each year, can take years off a mortgage.

In fact, there are more ways to do so than ever before, says Chris Kiskunas, a regional mortgage sales manager with RBC. First-time homebuyers, for example, are now required to qualify for a "prescribed rate" in order to ensure they are able to afford their mortgage even if rates rise. "That qualifying rate is often higher than the rate on the mortgage, so if clients want to repay their mortgage more quickly, I recommend they set their payment at the prescribed rate rather than the mortgage rate."

That difference will expedite repayment and provide a buffer when it comes to renewal time or if there is a change in personal circumstances, says Ms. Kiskunas.

Many homeowners miss opportunities to save interest because they actually think too big, she says. "If they don't have the 15 per cent their mortgage contract allows them to repay annually, for example, they assume there is nothing they can do. But if you read the contact, it's 'up to 15 per cent.' Even if you just prepay $1,000, you can significantly cut your amortization."

The key to paying less interest is reducing the period you borrow for, and today's historically low interest rates make that easier than ever before, says Frances Hinojosa, a mortgage specialist with BMO. "Homeowners with mortgages coming up for renewal now are finding rates much lower than they were paying. I often recommend that they keep their payments the same: the extra payment goes toward the principle, and it doesn't impact their day-to-day financial situation."

Having a plan is critically important, she says. "When you're thinking of buying a house, MLS (the realty website) can be addictive. But talk to a mortgage professional first. Figure out what all your costs will be, including property taxes, utilities and a contingency fund for future repairs."

Once you've created a budget, she recommends paying the difference between your current and future housing costs into a savings account. "We call it a stress test – you're becoming used to making that higher payment, and at the same time, you're saving money you can use to make a larger down payment."

Today's low rates are a gift, says Angela Calla, an accredited mortgage professional with Dominion Lending Centres. But if they're not utilized properly, "homebuyers may be faced with payment shock when their mortgages renew at more normal levels," she cautions.

Those who take advantage of today's low rates to pay their mortgages off faster are typically those who take advantage of the free services offered by their mortgage professionals to create individualized plans, she adds. "If you understand your own habits, it's easier to set yourself up for success. If you're not diligent about saving, for example, it's important to acknowledge that you're going to benefit significantly from setting up your mortgage right the first time."

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"Interest is front-loaded. It's really important to consider that you pay $3 in interest for every $1 toward principle in the early years, and to take advantage of the terms of your mortgage to make small changes up front that make a huge difference. If you have a monthly payment of about $1,000 and you pay $1,150, it will take 5.5 years off of a $200,000 mortgage, saving you up to $66,000 in future payments. And beware of mortgage rate fixation: inflexible mortgage terms can cost you much more." Angela Calla is an accredited mortgage professional with Dominion Lending Centres and host of CKNW's *The Mortgage Show*

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