

In this declining interest rate environment, I am receiving many questions from customers who want to break the terms of their existing mortgage to take advantage of the new lower rates. However, it is important that customers are aware that Interest Rate Differential (IRD) compensation may result.

Lets assume the following:

\$100,000 5 year fixed rated mortgage

Rate = 6.5%

Mortgage Broken after 3 years

Prevailing rate = 5%* (posted rate for the closest remaining term minus the most recent discount)

$IRD = 6.5\% - 5.0\% = 1.5\%$

Remaining Term = 2 years

$IRD \text{ Compensation} = \$100,000 \times 1.5\% \times 2 \text{ years} = \$3,000.00$ (equal to the Bank's lost revenue)

Given today's market conditions, some IRD amounts will be much greater than anything we have seen in the past. Further, when interest rates change, IRD compensation rates will also change, so it is important that customers act quickly once they have made the decision to discharge their mortgage.

Customers who have decided to discharge their mortgage can request a formal discharge statement for information purposes only, via their own solicitor or they can order one directly from the Institution they are with. Remember to request this information in writing.

- When determining the comparison rate, some lenders round up your remaining months to the next longest term. Some round down.
- The Interest Act prohibits IRD penalties on terms over 5 years, after five years has elapsed. In such cases, a maximum 3-month interest penalty may apply. For example, someone who has been in a 6-year mortgage for 60 months or more would pay a 3-month interest penalty (maximum) to break it before maturity.
- A small number of lenders prohibit breaking a mortgage early—regardless of the penalty—unless in the case of an approved bona fide sale.
- The moral: Always contact your lender directly for an exact penalty quote.

Have a question or comment?

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