How to Get a Lower Mortgage Rate Without Breaking Up With Your Lender

Description

The Bank of Canada is clear: sometime in 2022, it's going to hike up the prime rate. That means it's only a matter of time before historically low mortgage rates began an upward climb.

Of course, if those low rates have caught your eye, you might still be wondering if you can break your fixed mortgage contract to lock one in. The answer — yes. Let's take a look at a few ways to get a lower mortgage rate before the Bank of Canada hikes them up.

Blend-and-extend option

Blend-and-extend involves combining your current mortgage rate with a new one to create a blended rate. With the new rate, you also agree to another mortgage term with your lender. Hence "blend-and-extend."

You might pay administrative fees to blend-and-extend but nothing as high as the prepayment fees you'd pay by switching lenders entirely.

Let's look at an example. Let's say your current interest rate is 5.45% and you have 24 months left on your term. Your current lender offers a 3% interest rate for a five-year mortgage. Your eyes are watering, so you go for the blend-and-extend option.

To calculate your new rate, here's what your lender will do. First, they'll multiply your current rate by the number of months left on your term. So, in this example, we have

5.45% x 24 months = 130.8

Next, they'll take the difference between your new term and your old term. In this case, the difference is

60 months – 24 months = 36 months

Now, your lender will multiply this number by the new interest rate, so:

36 months x 3% = 108

At this point, your lender will take the sum of this number and the first number they calculated:

130.8 + 108 = 238.8

Finally (phew, right?), they'll divide this number by the number of months in your new term to get your new interest rate:

238.8 / 60 = 3.98%

So, in this case, your interest rate would be 3.98%, and you'd agree to extend your mortgage.

Blend-and-term option

Another option is blend-and-term. Like blend-and-extend, you combine your old rate with a new one. Unlike blend-and-extend, however, in this option, you don't extend your term. You simply finish out your old one.

Since rates are expected to go up, a blend-and-term mortgage might not be the best option. Of course, if could be right for you, if you're already planning on leaving your mortgage lender at the end of your term. But if you have more mortgage ahead of you, and you're okay staying with your current lender, you might be better off getting a blend-and-extend mortgage.

What about breaking up with your lender?

Yes, you can do that, too. But it will cost you. After all, if you agree to a mortgage term, your lender will expect interest payments for a certain period of time. Break your contract, and they'll want recompense for lost interest.

But sometimes you'll save more money over the long run by paying penalties now and taking a lower mortgage payment.

The best thing is to run the numbers yourself. First, calculate how much interest you will pay on your current mortgage, should you decide not to break your contract. Then calculate how much interest you'd pay on your new mortgage. Take the difference between the numbers and set it aside.

Next, find out how much it will cost you to break up with your current lender. Each mortgage is a bit different, so you'll want to communicate with your lender to get the specifics.

If the cost to break-up with your lender is higher than the savings in interest, it's not worth the lower interest rate. For instance, if you could save $10,000 in interest by switching to a mortgage with a lower rate, but it will cost you $12,000 to break your contract, you're losing money in the transaction.

Which option is right for you?

Perhaps the best thing you can do it run the numbers on each option. Decide how much you could save with a blend-and-extend (or blend-and-term). Then calculate how much you'd save (or lose) by breaking up with your lender. Whichever option results in more savings is probably the option you'll want to go with.

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