



## Mortgage Prepayment Penalties

### **Prepayment penalties**

A prepayment penalty is a fee that your lender may charge if:

- You break your mortgage contract
- You make extra payments over and above the yearly allowable (usually 15%-20% per year) prepayment privilege
- You transfer your mortgage to another lender before the term is up
- You refinance your mortgage and break your term

Prepayment penalties can cost thousands of dollars. It's important to know when they apply and how your lender calculates them.

You can base your estimate of your prepayment penalty on factors such as:

- how many months are left until the end of your term
- Current interest rates
- the method your lender uses to calculate the charge

The prepayment penalty will usually be the higher of:

- an amount equal to 3 months' interest on what you still owe
- the interest rate differential (IRD)

The interest rate differential is the difference between the interest rate on your current mortgage term and today's interest rate for a term that is the same length as the remaining time left on your current term.

Review your mortgage contract to find out exactly how your lender will calculate your prepayment penalty. Check with your lender for the actual amount. Ask your lender to explain anything you don't understand.

If you negotiated a discounted interest rate, the calculation of the interest rate differential will depend on the lender and the terms of your mortgage contract.

To calculate your prepayment penalty, lenders may use:

- the advertised interest rate at the time you signed your mortgage and the current posted rate for your term
  - your actual discounted interest rate and apply the discount to the current interest rate
  - your discounted interest rate for your current term and the advertised interest rate at the time the calculation is made
- Example: Estimate your prepayment penalty

## **Paying your prepayment penalty**

Your lender may allow you to add a prepayment penalty to your mortgage balance. This means you'll pay interest on your prepayment penalty. You can also pay your prepayment penalty up front.

## **Tips to reduce or avoid prepayment penalties**

Consider the following options to reduce the amount of money you may pay in penalties.

- Make full use of your prepayment privileges each year
- Make a lump-sum prepayment before you break your mortgage. Although, some lenders will restrict your ability to prepay if you're too close to the date you break your contract.
- Read your mortgage contract carefully. Ask questions about anything you don't understand.
- Wait until the end of your term to prepay - Consider waiting until the end of your term to prepay if your prepayment penalty will be a large amount. You can then make a lump-sum prepayment without penalty.
- Port your mortgage - If you're buying a new home, ask your lender if you can port your mortgage. This means taking your existing interest rate and terms and conditions with you to your new home. It saves you from breaking your mortgage contract and getting a new one
- Shop around when you renew your mortgage. Contact various lenders and mortgage brokers to check if there is a better mortgage option that will offer you more flexibility to make prepayments.

## **Questions to ask your lender about prepayments**

When shopping around for a mortgage, look for flexibility in prepayment privileges.

Ask your lender the following questions before signing a mortgage contract:

- how much you can prepay without paying a penalty
- if there's a fee for making a prepayment

- if there's a minimum or maximum amount for a prepayment
- when and how often you can make prepayments
- if there are any conditions related to prepayments
- if you can re-borrow any prepayments you made

## **What you need to know about prepayment penalties**

If a federally regulated financial institution, such as a bank, issues your mortgage, the following details must appear in an information box at the beginning of your mortgage agreement:

- prepayment privileges
- prepayment penalties, that is, prepayment charges
- other key details

Your lender must tell you how they will calculate your prepayment penalty. Your lender must also tell you what factors are used to determine the penalty. These details must be clear, simple and not misleading.

Read your mortgage contract carefully. Make sure you understand the details about penalties before you sign your contract. Ask questions about anything you don't understand.

Please visit The Government of Canada for the complete article

<https://www.canada.ca/en/financial-consumer-agency/services/mortgages/reduce-prepayment-penalties.html>