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

PAYING OFF YOUR MORTGAGE FASTER

Smart mortgage decisions start here

Financial Consumer Agency of Canada
IT PAYS TO KNOW.

Canada

TABLE OF CONTENTS

About FCAC

With educational materials and interactive tools, FCAC provides objective information about financial products and services and informs consumers about their rights and responsibilities when dealing with banks and federally regulated trust, loan and insurance companies. Through its financial literacy program, FCAC helps Canadians increase their financial knowledge and confidence in managing their personal finances. FCAC also makes sure that federally regulated financial institutions respect the laws and agreements that protect consumers.

You can reach us by phone through our toll-free Consumer Contact Centre at 1-866-461-3222 (TTY 613-947-7771, or 1-866-914-6097), or by visiting our website at **fcac.gc.ca**.

Cat. No.: FC5-22/4-2010E-PDF

ISBN: 978-1-100-16356-7

June 2010

OVERVIEW

You have choices that can help you pay off your mortgage faster and save a lot of money in interest charges. It all starts with understanding how your payment is applied to the principal and interest you owe, and the options your mortgage lender can offer you.

UNDERSTANDING PRINCIPAL VERSUS INTEREST

How your payments are applied

For each mortgage payment you make, the money is first used to pay the interest on your mortgage loan. The remaining portion of your payment is then used to reduce the principal, which is the amount that you borrowed from the lender.

In the first years of the mortgage, most of the payment normally goes toward the interest costs. As a result, the principal, or the amount that you owe, may decrease by only a small amount. As the mortgage balance decreases over time, more of each payment goes toward paying off the principal.

During a 25-year mortgage, depending on the interest rates charged on your mortgage, the total amount of your payments could be double the principal amount that you originally borrowed, or even more.

The key to saving money on your mortgage is to pay off the principal as fast as possible. If your household budget allows you to reduce the time you need to pay your mortgage in full, you could save thousands, or even tens of thousands of dollars in interest charges.

Learn more about some payment options that will help you pay off your mortgage faster in the pages that follow.

Remember

The faster you reduce the amount left to pay on your mortgage, the more you will save in interest charges.

WAYS TO PAY OFF YOUR MORTGAGE FASTER

1. INCREASE THE AMOUNT OF YOUR PAYMENTS

One of the ways to pay off your mortgage faster is to increase the amount of your regular payments. Normally, **once you increase your payments, you will not be allowed to lower your payments until the end of the term**. Check your mortgage agreement or contact your mortgage lender for your payment options.

EXAMPLE

- John is getting a mortgage of $150,000, amortized over 25 years, with a fixed interest rate of 5.45% for 5 years.
- The mortgage lender tells him that that he must pay at least $911 a month.
- He is trying to decide if paying $50 more a month will help him save money.

Assumptions

- The interest rate of 5.45% remains the same over the 25-year mortgage.

	Total payments over the life of the mortgage	
	Monthly payment at $911	**Monthly payment at $961**
Principal	$150,000	$150,000
Interest payments	$123,368	$108,859
Total amount paid	**$273,368**	**$258,859**
Interest savings	**–**	**$14,509**
Years to pay off	**25**	**22.5**

By paying an extra $50 a month over the life of the mortgage, John would **save over $14,000 and pay off the mortgage two and a half years sooner**.

2. IF YOU RENEW WITH A LOWER RATE, KEEP THE MONTHLY PAYMENTS THE SAME

At the end of your mortgage term, when you renew or renegotiate your mortgage, you may be able to obtain a lower interest rate. Although you would have the option of reducing the amount of your regular payments, you can take advantage of this situation to pay off your mortgage faster. Simply keeping the amount of your payments the same will make you mortgage-free sooner.

EXAMPLE

- Stefanie used to pay $1,000 each month on a $150,000 mortgage.
- When she renewed her mortgage after five years, the interest rate had decreased by one percent, from 6.45% to 5.45%.
- While the lower interest rate would have reduced Stefanie’s monthly payments to $924, Stefanie decided to keep the monthly payment at $1,000 in order to reduce the total amount of interest she will pay over the term of the mortgage.

Details

- Stefanie is renewing her mortgage after five years for another five-year term.
- The remaining mortgage principal amount is $135,593.

Assumptions

- The new interest rate of 5.45% would remain the same for the rest of the mortgage.

Keeping the same payments while renewing at lower interest rates

(over the life of a 20-year mortgage at 5.45%)

	Monthly payments	
	at $924 (new minimum payment)	**at $1,000 (maintaining previous payment)**
Principal	$135,593	$135,593
Interest payments	$86,228	$73,916
Total amount paid	**$221,821**	**$209,509**
Interest savings	**–**	**$12,313**
Years to pay off	**20**	**17.5**

By keeping the monthly payments at $1,000 per month with the lower interest rate for the rest of her mortgage, **Stefanie will save over $12,000 and will pay off the mortgage two and a half years sooner**.

3. CHOOSE AN "ACCELERATED" OPTION FOR YOUR MORTGAGE PAYMENT

You can spend approximately the same amount of money on your mortgage each month and still save money by choosing an accelerated option for making your payments.

Most financial institutions offer a number of payment frequency options:

Less frequent → More frequent	
Less frequent	monthly
	semi-monthly
	biweekly
	accelerated biweekly
	weekly, and
More frequent	accelerated weekly

Accelerated payment options

Accelerated weekly and accelerated biweekly payments can save you thousands, or even tens of thousands in interest charges, because you'll pay off your mortgage much faster using these options.

The reason is that you make the equivalent of **one extra monthly payment per year**.

Standard payment options

The standard payment options are

- monthly
- semi-monthly
- biweekly
- weekly.

For these four payment options, there is no difference in the total amount you will pay over a year. This means that there is very little extra savings if you switch from a monthly payment option to one of the other standard payment options.

EXAMPLE: IMPACT OF CHANGING THE PAYMENT FREQUENCY

The table below shows the payment frequency options offered to John by his lender, their impact on his mortgage payments and how much he can save over the amortization period.

Mortgage details

- Mortgage principal of $150,000 amortized over 25 years
- Interest rate of 6.45% for the entire amortization period

	Payment frequency	Number of payments per year	Payment amount	Total payments per year	Interest saved on mortgage
Less frequent	Monthly	12	$1,000	$12,000	–
	Semi-monthly (twice a month)	24	$500 ($1,000 ÷ 2)	$12,000	$162
	Biweekly (every two weeks)	26	$462 $\left(\frac{\$1,000 \times 12}{26}\right)$	$12,012	$174
	Accelerated Biweekly	26	$500 ($1,000 ÷ 2)	$13,000	**$29,407**
	Weekly	52	$231 $\left(\frac{\$1,000 \times 12}{52}\right)$	$12,012	$249
More frequent	Accelerated weekly	52	$250 ($1,000 ÷ 4)	$13,000	**$29,751**

Note: This example assumes a mortgage of $150,000, amortized over 25 years, with a constant interest rate of 6.45%.

By choosing an accelerated payment frequency, John makes the equivalent of one extra monthly payment a year. **John will pay off his mortgage over four years sooner and will save over $29,000 in interest over the amortization period.**

4. MAKING LUMP-SUM PAYMENTS: PREPAYMENTS

A prepayment is a lump-sum payment that you make, in addition to your regular mortgage payments, before the end of your mortgage term. The prepayment reduces your outstanding balance and allows you to pay off your mortgage faster.

The sooner you can make the prepayment, the less interest you will pay over the long term, and the sooner you will be mortgage-free.

Key things to remember

- Your mortgage agreement will specify whether you can make prepayments, when you can do so and other related terms or conditions. Read it carefully, and ask your mortgage lender to explain anything you don't understand.
- If your mortgage lender is a federally regulated financial institution such as a bank, as of January 2010, it must show your prepayment options in an information box at the beginning of your mortgage agreement.
- Your mortgage agreement may specify minimum and maximum amounts that you can prepay each year without paying a fee or penalty.
- The prepayment option is generally not cumulative. In other words, if you did not make a prepayment on your mortgage this year, you will not be able to double your prepayment next year.
- A closed mortgage agreement may require you to pay a penalty or fee for any prepayment.

Questions to ask

When shopping for a mortgage, make sure that you understand the prepayment options and conditions **before** you sign the contract. Ask the lender the following questions:

- How much can I prepay without paying a fee or penalty?
- Is there a minimum amount for a prepayment?
- When can I make prepayments?
- Are there any conditions?
- If there are fees or penalties, how much are they, and how are they calculated?

EXAMPLE

- John received a raise which allowed him to save $15,000.
- He decides to use it to make a prepayment on his mortgage at the beginning of the second year of his term.
- However, his mortgage lender limits prepayments to a maximum of 10% of the principal.
- John wants to know whether he can make that large a prepayment, and if so, how much sooner he will be able to pay off his mortgage as a result.

Details

- Mortgage of $150,000, amortized over 25 years
- Lump-sum payment limit: 10% of principal allowed once a year

Assumptions

- Interest rate will be 5.45% for the entire 25-year mortgage

Calculation of the maximum prepayment allowed

Original mortgage:	$150,000
Limit allowed by John's mortgage lender:	x 10%
Allowed lump sum payment:	= $15,000

John will be able to use his raise to make a $15,000 in lump-sum payment, since he is allowed to prepay up to $15,000 each year.

Over the mortgage period	No prepayment	Prepayment (beginning of second year)
Prepayment lump sum	–	$15,000
Principal	$150,000	$150,000
Interest payments	$123,368	$90,168
Total amount paid	**$273,368**	**$240,168**
Interest savings	**–**	**$33,200**
Years to pay off	**25**	**20.7**

Making the prepayment will reduce the amount of interest John will have to pay over the life of the mortgage by over $33,000, and he will be able to pay off the mortgage over four years sooner.

CONCLUSION

You can save thousands of dollars in interest by paying off your mortgage as fast as your household budget allows. These four ways will help you to achieve the goal of being mortgage-free sooner:

- increasing the amount of your payments
- keeping your payments the same amount if you renew or renegotiate your mortgage with a lower interest rate
- choosing an accelerated payment schedule
- making lump-sum prepayments.

With your mortgage paid off, a big part of your household budget will be available to help you to achieve your other financial goals.

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

Accelerated bi-weekly

A payment frequency that allows you to pay half the monthly payment every two weeks. Since there are 52 weeks in a year, you will make 26 payments a year (52 ÷ 2). To calculate the amount of your accelerated biweekly payments, divide your monthly payment by two (for example, $1,000 ÷ 2 = $500). You make the equivalent of one extra monthly payment per year, which means you will pay off your mortgage faster and save in interest charges.

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.

Interest

The amount paid by a borrower to a lender for the use of the money.

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.

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.

Principal

The amount of money that you borrowed from a lender to pay for your home.

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**.