Is refinancing your mortgage a good idea?

Thinking about refinancing your mortgage? There are various ways to do so. And depending on your goals, one strategy will likely be better than another. Take the time to carefully evaluate your options to get the most out of your mortgage refinancing.

Refinancing your mortgage gives you the ability to use the equity you have in your property to borrow money. It is commonly referred to as “remortgaging your home.”

Some homeowners use mortgage refinancing to get a better interest rate. However, this involves breaking the existing mortgage, a decision that is not always to your advantage.

Better interest rate? Beware of penalties

Thinking of terminating your mortgage and negotiating a new one at a lower rate? Breaking a mortgage contract before it comes to term always triggers a penalty. Depending on the time remaining on your contract, the amount of the penalty could outweigh the savings you were hoping to achieve. In fact, it may cost several thousand of dollars. And that’s not including the administrative costs you will have to pay to obtain a new mortgage, such as legal and appraisal fees.

A mortgage advisor can tell you the amount of the penalty that would apply in your situation. This will help you to determine whether replacing your mortgage before maturity makes financial sense.

Keep in mind that there are ways to save on interest costs without having to refinance your mortgage. You can, for instance, increase the frequency of your mortgage payments, or opt for an accelerated mortgage repayment strategy.

Tap into your home’s equity to increase your liquidity

Want to refinance your mortgage in order to have an additional source of credit? By accessing the equity you have in your home, you can enjoy a much lower interest rate than that of a personal loan. And you can borrow up to 80% of the market value of your property, minus the balance remaining on your current mortgage.

Let’s say your home is worth $300,000, and you have $150,000 left to pay on your mortgage. By remortgaging, you could borrow an extra $90,000: ($300,000 x 80%) – $150,000 = $90,000. Your new debt would therefore be $240,000, i.e. the remaining balance on your mortgage plus the new amount you have borrowed.

Refinancing your mortgage to consolidate your debts

If you have high-interest-rate consumer debts, you can consolidate them in a mortgage, provided you have already paid off a portion of it. But although this may help to ease your financial situation, remortgaging your home does involve risk. Because the home is used as collateral to secure the loan, you may lose your home if you are unable to make your monthly mortgage payments.

Home equity line of credit

Another refinancing option available is the home equity line of credit. This can give you access to funds of up to 65% of the equity of your property, which is its appraised value minus the balance on the existing mortgage. This can be a good way to finance a project without even having to modify your mortgage. And you won't have to pay a penalty.

The other advantage of this type of line of credit is its flexibility. You can withdraw money when you need it. You decide on the amount and the frequency of your repayments. You can even choose to pay only the interest each month without paying down the principal. And if extra cash becomes available to you, you can pay off your entire home equity line of credit without incurring a penalty.

Note that this financial product is best suited to people who are very disciplined. Since the only requirement is to pay the interest, there is a risk of winding up having to pay off the entire principal when the house is sold.

Depending on your situation, refinancing your mortgage may be a good idea. But before going that route, it's in your best interest to know exactly what penalties and financial obligations you can expect. Your advisor can help you choose the optimal strategy.

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