Reality Check: Interest Rates and Mortgage Renewals

Managing Your Money

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I was at a wedding recently and all the talk at the table was about interest rates and mortgage renewals. It's scary to think that only about a third of mortgage holders have actually been affected so far. That means there are a whole lot of people out there who still haven't experienced the shock of higher rates. The good news is that while there still could be more rate hikes ahead, the biggest increases are behind us.

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The impact of these 2022 rate hikes is most significant on individuals who have mortgages. After decades of low rates, many people are not prepared for the reality ahead as their mortgages renew. So here are some things to consider, both to prepare for the "blow" and to manage it.

Know what's coming: I'd say the first thing you want to do is call the financial institution holding your mortgage. Ask for an estimate of what your payment would be if you renewed it today, at current rates. Consider how this new payment fits into your current financial situation. Can you manage it? Will it add significant financial stress? Are you not able to afford it? Be prepared so you can plan ahead.

I recently went through this exercise with a client who had a $900,000 mortgage 5 years ago. She has been paying $3,700/month. Now with current rates, the $750,000 that she still owes is going to cost her $5,600/month. That's a 50% increase, to the tune of almost $2,000/month! For those like my client who have all their income budgeted, the challenge is where to find that extra money. In her case, it meant reducing what was going into savings. Others may not have that flexibility and be forced to make bigger sacrifices. So, what are some other options?

Mortgage Relief Measures: As I mentioned, the first stop should be your bank or lending institution. The Financial Consumer Agency of Canada (FCAC), a government agency that supervises banks, has certain expectations. FCAC expects banks to help individuals who may be struggling to pay their mortgages due to exceptional circumstances. They are expected to provide you with clear information and assistance and make their relief measures easily accessible to you. For more info about relief measures you should be offered, visit www.canada.ca/en/financial-consumer-agency.html

Extend Amortization: One of the most popular options financial institutions are offering right now is extended amortizations. This will lower payment amounts - but at a cost. When looking at this option, make sure you understand the impact of it on the total cost of your mortgage in the long term. It's not necessarily the best option because you end up paying way more in the long run, but it may 'save you' in the short term. The bottom line is that it's important to know your options.

Pause the dream / Take a step back / Create room to breathe: This summer I had a client call me asking to withdraw a large sum of money. It was to help their son, who got married a few years ago and bought a home that was over budget. The son and his wife are now choking financially from all the pressures of the lifestyle they've been trying to maintain. Not everyone has parents who can (or will!) swoop in to "save the day". When people "buy too big" whether it's houses, cars, or just general lifestyle, the smart ones rein it in before it's too late. It can be devastating to sell a dream house or dream car, but the stress relief and reduced anxiety of being able to breathe financially is priceless.

Create tax savings: Over the past few decades, I have often had clients ask, "Should I pay down my mortgage?" And up until recently, my answer was usually "no". With mortgage rates under 2%, it made sense to build up cash (or investments) outside of the home. If you have cash…you have options. At renewal, you can pay down some of the principal, which again may not be the best long-term strategy, but could relieve stress in the short term. A more interesting option may be to use a debt replacement strategy to make the interest on your mortgage tax deductible. Which option makes sense will depend on many factors such as your age, tax rate, how much in liquid investments you have, etc.

Assess Lifestyle: Assessing lifestyle spending is an exercise that should be done regularly anyway – start with getting a realistic perspective on what are needs and what are wants. Then break down EVERYTHING you spend into one of the two columns. No doubt everyone needs a roof over their head, but if you've gone off and bought a castle that is over your budget, break down your housing costs and mortgage into both columns – what part is a basic need, and what part would be considered a want. Maybe you pay for a streaming service like Netflix but do you 'need' ten streaming services? If you pay for a gym membership and use it regularly, maybe it's a need. If you had good intentions but rarely use it, it's a 'want'. And if it's a super high-end gym, and you use it, maybe you can break it into both categories.

This lifestyle spending exercise can be tedious, but most people also find it incredibly enlightening. I often have clients do it, regardless of their financial situation. I have witnessed clients do this exercise diligently and easily save hundreds if not thousands of dollars each month. It can also bring attention to social spending that may be influenced by their circle of friends. When someone needs or wants to lose weight, the solution can often be found in their diet. When someone has financial stress, the solution can often be found in their lifestyle spending. Just as we don't like giving up the things that we enjoy eating, we often don't want to give up the things we enjoy spending on… it all comes down to priorities and choices. For our Lifestyle Spending tool, visit the Useful Tools page on our website under Resources.

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If higher interest rates are stressing you out, remember they won't last forever. Increasing interest rates is a tool the government uses to control inflation. At the heart of Canada's monetary policy is the inflation-control **target**, which is 2%. Once inflation is under control, the government will start bringing interest rates back down, aiming for that target inflation rate. Until then, seek guidance from a professional who has expertise in debt management to get over this wave.

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