

Should you consider a cash-back mortgage?

Maybe your mother told you that if something looked too good to be true... then it probably was. For a few years, several lenders have been offering mortgages that actually give you some cash back – a rebate – when you take out your mortgage. Usually, you get a nice fat cheque within a week of the mortgage closing.

It's a pretty compelling psychological boost, isn't it? Just when you're feeling a bit house-poor, some money lands in your lap, which could be up to 5% depending on your lender and the mortgage term you selected. Talk about cashing in!

While the cash-back mortgage can be the product of choice for the right client, it can be a mistake for others. That's why you should make sure you take the cash rebate for the right reasons. Maybe you're a first-time buyer and you need help with your downpayment; you're frustrated with the length of time it is taking you to save and you want to own your home now. Or, you need some extra funds for a few important improvements or purchases – like fresh carpeting or appliances, for example. Those extra funds could make the difference in whether or not you have a comfortable, liveable home. Or maybe the rebate can provide the necessary funds for moving expenses and legal fees. These cash-back mortgages have their place – and not surprisingly, first-time buyers account for most of the cash-back mortgages in Canada.

As convenient as they are though, cash-back mortgages come at a cost. And that's why they aren't for everyone. In exchange for the financial wiggle room you get with a mortgage rebate, the lender will charge a higher interest for the mortgage. And, of course, the extra money you pay will be more than the nice rebate cheque you received.

Let's look at an example. Say you are considering a 5-year mortgage with 3% rebate for your \$200,000 mortgage, amortized over 25 years. You get a very handsome rebate of \$6,000. But maybe your interest rate leaps more than a point, from 5.8 to 7%. In effect, you pay that rebate back over the 5 years – forking out an extra \$8,694 in payments. If that seems like a reasonable deal, then consider this: the outstanding balance of your mortgage will be \$2,928 higher than if you'd just got a regular mortgage at the lower rate. The total cost for your \$6,000 rebate would then be \$11,622. If you invested the \$6,000 that you received five years earlier, you'd need to earn almost 14% each year to break even. Takes a little of the glow off that shiny rebate cheque, doesn't it?

If it is worth the convenience and one-time financial relief, then you should discuss cash-back mortgages with an experienced mortgage planner. Keep in mind that if you discharge the cash-back mortgage prior to the end of the term, you'll also need to pay back the rebate you received on a pro-rated basis, in addition to the usual prepayment penalties and fees.

There's no question that cash-back mortgages will help many Canadian homeowners smooth the transition to home ownership, especially now that no-downpayment mortgages are no longer available. Now, a 5% downpayment is required, although under flex down programs, you can get that downpayment through borrowing or cash-back incentives at a slightly higher insurance premium, which would add an additional \$300 to the overall cost.

If you feel though that a cash-back mortgage is right for you, be sure to have a frank discussion – with an experienced mortgage planner – about the tradeoff of what you get now versus the longer-term cost of that choice.

Mark Goode AMP

Agent #M08003177

Mortgage Broker

180 Memorial Avenue, Orillia, ON L3V 5X6

T: 705.326.8523 TF: 1-866-326-8523

mark@markgoode.ca

www.markgoode.ca



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