Canada

Canadians refinancing mortgages to pay off debts

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VANCOUVER, B.C. -- Record low interest rates are spurring more Canadians to refinance mortgages to consolidate debt, a trend that is expected to grow as Ottawa moves to loosen lending conditions and encourage spending on housing.

While refinancing your mortgage at a lower interest rate can save you money even after paying a penalty, experts warn there are dangers to taking out bigger mortgages with home values dropping and unemployment rates rising.

Laurie Campbell, executive director of Credit Canada, a non-profit credit counselling organization, said while it makes sense to pay off a credit card with a 19-per-cent interest rate with money from a higher mortgage at a rate of just four or five per cent, there can be "a false sense of security."

She said people who already have a problem paying off credit cards are usually the first to repeat the mistake of getting more heavily into debt.

"We have seen it over and over again in our office," said Campbell.

"People have great intentions and get a line of credit or a home equity loan or refinance their mortgage to get out of a scathing debt situation, only to turn around and rack up their credit cards again."

She also said people who refinance their mortgages to consolidate debt are often taking out a bigger mortgage.

A recent survey by the Canadian Association of Accredited Mortgage Professionals, which represents Canada's $900 billion mortgage industry, shows about one in five borrowers took out an increased amount of cash from their mortgages when refinancing.

The November survey showed the average draw rose 20 per cent to $41,000 compared with a year earlier.

Of those surveyed who took out larger mortgages, 56 per cent said they used the money - which totals $18.5 billion nationally - for debt consolidation and repayment. About 30 per cent of these funds went

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towards home repair and renovation.

Meantime, statistics kept by the Canadian Bankers Association show the number of mortgages in arrears has grown to 0.31 per cent in November, or 12,048 mortgages, from a total of 3.9 million mortgages nationwide.

That's a 22 per cent increase in the number of arrears compared with 0.26 per cent or 9,862 in November, 2007, when there were about 3.81 million mortgages in Canada.

The rise in mortgage levels and arrears comes as Ottawa announced plans in its federal budget Tuesday extending the Insured Mortgage Purchase Program by an extra $50 billion to $125 billion.

The move is meant to encourage banks to increase mortgage lending, especially after Finance Minister Jim Flaherty and Bank of Canada Gov. Mark Carney began urging the banks to increase money available for loans to consumers and companies.

Ottawa also offered a temporary home renovation tax credit of up to $1,350 toward a wide variety of home improvements, increased the RRSP withdrawal limit for qualified home buyers to $25,000 from $20,000, and introduced up to $750 in tax relief for closing costs for new first time home buyers.

Jim Murphy, president and CEO of the mortgage group also known as CAAMP, said Ottawa's moves are needed during these uncertain economic times. For example, consumer confidence is at its lowest level in more than a quarter century, unemployment is rising and house prices are falling in many Canadian markets, recent reports show.

"These are all measures aimed at trying to instill confidence in the housing market, " said Murphy.

"I think the key message is the need for consumer confidence, and governments have an important role to play in that."

But Campbell said she is concerned about the already "unstable" debt levels out there today.

"I understand the logic of spending your way out of a recession," she said, but added that Canadians "due to high debt levels are in no position to do that."

She points to a recent Vanier Institute study that found the average household debt in Canada surged to over $90,000 last year, while the total debt to disposable income ratio climbed to 140 per cent.

"To encourage spending during the highest ever debt levels in Canada unfortunately is problematic," Campbell said.

Justin Blacklock, mortgage manager at Averbach Mortgages in Vancouver, said his company has been getting a lot of calls recently from customers wanting to refinance mortgages.

He said rates for most fixed mortgages have dropped by about one percentage point in recent months.

Blacklock said while refinancing is a great idea for many people - even after a typical penalty of three months' interest - there are many factors to consider, especially if the value of your home has dropped.

They include possible legal costs, the price of a possible bank appraisal of your home, and the loan-to-value ratio on your property.

For instance, if you borrowed against 90 per cent of your home, and the value dropped 10 per cent, you may not be able to refinance at all.

Blacklock also said people with 40-year amortization terms on their mortgages, which are no longer available in Canada, may also be unable to refinance if their credit isn't strong enough.

"Before people get excited about saving $200 on month, they need to realize that some people aren't eligible (for refinancing)," Blacklock said.