A Seller's Strategy during Falling Interests Rates

2001 will be remembered as the year interest rates fell to an all-time 30 year low. As the rates declined, home affordability increased new buyers into the market and upgraded the buying power of those already shopping. Home sellers rejoiced, minus the home seller with a large existing mortgage.

Imagine a seller who has a $75,000 – 7% mortgage on the $100,000 home. The home was only purchased a year ago, and unexpectedly, their plans changed and are moving. The interest rate on their mortgage is higher than current market rates, initially, a buyer would rather arrange for a new mortgage rather than assuming the existing one. Now the problem with this is the seller probably has to pay a penalty for early payout of the existing mortgage. The penalty could be avoided if the buyer took over their mortgage, but only if an agreeable price reduction would persuade a buyer into a mortgage with a higher interest rate. Payout penalty or price reduction; these are not attractive choices!

There is another option: the seller can buy down the interest rate. They ask the mortgage company what it would cost to buy down the 7% rate to the current rate. The mortgage company calculates the cost of the lost interest and allows the seller to pay it up front. On average, this is significantly less than a payout penalty or a price reduction. In addition, the buyer's cost, associated with assuming a mortgage, is typically less than arranging a new one. Now, the mortgage has become an attractive selling feature.

Here is an example of the cost* of buying down a 7% mortgage (calculated by www.canadamortgage.com):

$75,000 mortgage at 7% For 25 years	Buy down to 6%	Buy down to 5%
For 24 months	$1,337*	$2,673*
For 12 months	$698*	$1,397*

**Other costs may apply: legal fees, administrative costs*

The buy down cost is determined by two factors: the interest rate differential and the length of time that the rate will be reduced. Smaller rate differential and the shorter period of time for the rate reduction, the less it costs to buy down the rate.

The seller should examine some alternatives during this arrangement. There may be other associated costs such as legal fees and administrative fees from the lender. Exact costs should be confirmed in writing in advance. Also, the seller should determine if they have any legal liability for the mortgage after the buyer assumes it. Always obtain expert advice beforehand.

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