A CANADIAN HOMEOWNER'S GUIDE

The Penalty for Breaking Your Mortgage Early

The IRD Trap

Why the same mortgage can cost one person $6,000 and another $22,000 — and how to land on the right side.

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What's inside this guide

Breaking a mortgage early is one of the most expensive surprises in Canadian real estate — and one of the least understood. This guide walks you through exactly how the penalty works, with a real worked example, so the number never blindsides you.

01 What “breaking” a mortgage really means

Most people think “breaking a mortgage” means defaulting or walking away. It doesn’t. You break a mortgage any time you end or change your contract before the term is up — and most of the reasons are completely ordinary:

- **Selling your home** before the term ends and paying off the mortgage.
- **Refinancing** to grab a lower rate, or to pull out equity.
- **Switching lenders** at renewal or mid-term for a better deal.
- **Renewing early** to lock a rate before yours comes up.

Because almost every Canadian mortgage is a ***closed*** mortgage (lower rate, less flexibility), ending it early triggers a **prepayment penalty** — the lender’s compensation for the interest they expected to earn and now won’t. The whole game is knowing how big that penalty is ***before*** you make the move, not after.

> You don’t have to default to get penalized. Selling, refinancing, or switching early all count as breaking your mortgage.

02 The two kinds of penalty

There are only two ways a Canadian lender calculates this penalty. Which one you face depends mostly on whether your rate is variable or fixed.

3 Months' Interest

Usually: variable-rate mortgages

Simple and predictable — roughly three months of interest on your balance. Often a few thousand dollars.

The IRD

Usually: fixed-rate mortgages

The Interest Rate Differential. Can be far larger — sometimes five figures — depending on rates and your lender's method.

> **THE ONE RULE THAT DECIDES IT**
>
> On a closed **fixed**-rate mortgage, you pay the **greater** of the two — three months' interest *or* the IRD, whichever is higher. When rates have fallen since you signed, the IRD is almost always the bigger of the two, which is exactly why it catches people off guard.

This guide focuses on the IRD, because it's the one that produces the eye-watering numbers — and the one almost nobody understands until the payout statement lands.

03 What the IRD actually is

The name sounds technical, but the idea is simple once you see what the lender is protecting.

SIMPLY PUT — **Interest Rate Differential (IRD):** the lender's charge for the interest they lose when you break a higher-rate mortgage while current rates are lower. It's the gap between the rate you agreed to pay and the rate they could get today, applied to your balance for the time left on your term.

Think of it from the bank's side. You locked in at, say, 5%. Rates have since dropped to 3%. If you walk away early, the bank now has to re-lend that money at 3% — earning ***less*** than your contract promised. The IRD makes them whole for that difference over the remaining term. That's the entire logic.

THE HONEST TAKEAWAY

The IRD bites **hardest when rates have fallen** the most since you signed. If rates have risen instead, the IRD is often tiny — and you may only owe the simple three-months'-interest penalty. Direction of rates is everything.

The general formula every lender starts from looks like this:

IRD = (Your rate − Comparison rate) × Balance × Years remaining

Simple enough — until you ask one question that changes everything: **which comparison rate does the lender use?** That single choice is where the penalty quietly doubles, and it's the subject of Section 05. First, let's walk the basic math end to end.

04 The calculation, worked end to end

Let's make it concrete with one example. The numbers below are ***illustrative*** — chosen to show how the pieces fit, not to predict your mortgage. Meet a homeowner selling early:

THE SCENARIO

Mortgage balance: **$400,000** · Your fixed rate: **5.00%** · Time left on term: **3 years**

Today's comparison rate for a 3-year term: **3.00%**

First, the simple penalty — **three months' interest**:

$400,000 × 5.00% *one full year of interest at your rate*	**$20,000**
÷ 12 × 3 *take three months' worth*	**≈ $5,000**

Now the **IRD**. The rate gap is 5.00% − 3.00% = 2.00%, applied to the balance, for the three years remaining:

Rate gap: 5.00% − 3.00% *what the lender "loses" per year*	**2.00%**
× $400,000 balance *applied to what you still owe*	**$8,000 / yr**
× 3 years remaining *for the rest of your term*	**$24,000**

So in this example, the two penalties are roughly **$5,000** (three months' interest) versus **$24,000** (IRD). Because you pay the **greater** of the two on a fixed mortgage, the penalty here is **$24,000**.

> **WHY THE GAP IS SO LARGE**
> Notice what drove it: a **2% rate drop** across a **large balance** over **three full years**. Shrink any one of those — less time left, a smaller balance, a smaller rate drop — and the IRD falls fast. That's your lever, and it's why timing matters so much.

This is the ***clean*** version of the math — the way it works when a lender compares your rate to today's *actual* rate. Many of the Big banks don't do it this way. They use a method that quietly inflates the number, and that's the trap most people never see coming.

05 The trap that doubles the bill

Here's the single most important thing in this entire guide. The IRD formula has one moving part that the lender controls: the **comparison rate**. And there are two very different ways to set it.

> SIMPLY PUT — **Posted rate vs. discounted rate:** the posted rate is the sticker-price rate a bank advertises but rarely charges. The discounted rate is what you actually got. When you signed, the bank may have posted 6.80% but given you 5.00% — a 1.80% discount.

The fair method compares your rate to today's real rate. The **posted-rate method** does something sneakier: it takes today's posted rate, subtracts the original discount they gave you, and uses ***that*** as the comparison — producing a much bigger gap. This is the method the Big banks typically default to.

> **HOW THE DISCOUNT GETS USED AGAINST YOU**
> The bank gave you a discount at signing — then **subtracts that same discount from today's comparison rate**. A lower comparison rate means a wider gap, and a wider gap means a fatter penalty. The very discount that felt like a win becomes the lever that inflates your exit cost.

The result, on the exact same mortgage, can roughly **double** the penalty depending on who your lender is:

Big banks

Posted-rate method

Use posted rates on both sides of the differential. On a typical fixed mortgage, this can produce a penalty two to three times larger.

Many credit unions & monolines

Discounted-rate method

Compare your actual rate to today's actual rate. The gap stays realistic — and the penalty often lands at roughly half.

> **THIS IS THE WHOLE REASON TO READ YOUR CONTRACT**
> Two people with identical mortgages can pay wildly different penalties for one reason: **the method buried in their mortgage document**. It's not negotiable after the fact — but knowing it before you choose a lender, or before you break, is worth thousands.

06 ✓ How to shrink it — or skip it entirely

A penalty isn't always unavoidable. Depending on your situation and your contract, several moves can reduce it to a fraction — or erase it completely.

- **Port your mortgage.** If you're buying a new home, most closed fixed mortgages let you carry your existing rate and term to the new property — so you're not breaking it at all, and no penalty applies. You typically have a window of about 30 to 120 days between selling and buying.
- **Blend and extend.** Instead of breaking, some lenders blend your current rate with today's rate and extend your term — often with the prepayment penalty waived. Useful if you want a lower rate or more borrowing without paying to exit.
- **Time it near renewal.** Many lenders let you renew early — often up to 120 days before your term ends — with no penalty. If you're within a few months of renewal, waiting can save the entire charge.
- **Prepay first.** Most mortgages allow a yearly lump-sum prepayment. Paying down the balance before you break means the penalty is calculated on a smaller number.
- **Read your specific clauses.** Federally regulated lenders must spell out how your penalty is calculated. The method, the comparison rate, the privileges — they're all in your document. That's where the real answer lives.

> **WHEN BREAKING STILL MAKES SENSE**
> A penalty isn't automatically a reason to stay. If the interest you'd save by refinancing — or the gain from selling into a strong offer — clearly **exceeds** the penalty plus discharge and legal costs, breaking can be the smart move. The point isn't to fear the penalty. It's to ***measure it*** before you decide.

07 Before you break anything

Run through this before you sell, refinance, or switch — it turns a scary unknown into a number you can actually plan around.

- ✓ **Get your exact payout statement.** Ask your lender in writing for the precise penalty — never rely on a guess or a rule of thumb.
- ✓ **Find out which method they use.** Posted-rate or discounted-rate? This one detail can change the penalty by thousands.
- ✓ **Check if porting fits.** Buying again? Carrying your mortgage over may avoid the penalty entirely.
- ✓ **Ask about blend-and-extend.** Often a penalty-free way to lower your rate or borrow more.
- ✓ **Count the full cost to exit.** Add discharge fees, legal costs, and appraisal — not just the penalty itself.
- ✓ **Compare it to the gain.** Break only if the savings or sale proceeds clearly beat the total cost.

> The penalty is rarely the real problem. Not knowing the number — and not knowing your options — is.
>
> *Measure it, weigh it, then decide with your eyes open.*

Thinking of selling or refinancing?

Talk to a licensed mortgage professional first — ask for your exact payout figure, which calculation method they use, and whether porting or a blend-and-extend fits your situation. If you've had that conversation and still have questions, reach out to me on Instagram **@jayp.realestate** and I'll help however I can.

This guide is general education, not financial, legal, or mortgage advice. Penalty calculations, methods, and lender policies vary and change over time. All figures shown are illustrative examples, not quotes. Always obtain an exact payout statement from your lender and consult a licensed mortgage professional before making any decision.