Mortgage *Rates & Terms*

The rate debate is a hot topic in the mortgage world. Not just the rates itself, but the importance of the rate versus other factors in the mortgage - such as terms and penalties. As a borrower, it can be easy to get caught up in one thing but, if you're not paying close attention, ignoring other factors could cost you in the long run.

Fixed vs. Variable Mortgage

Fixed-Rate Mortgage: First-time homebuyers and experienced homebuyers typically love the stability of a fixed rate when just entering the mortgage space. The benefit of fixed-rate is that your payments don't change throughout the life of the term. However, should the Prime Rate drop, you won't be able to take advantage of potential interest savings.

Variable-Rate Mortgage: These mortgages are based on the Prime Rate in Canada and the amount of interest you pay on your mortgage could go up or down, depending on the Prime. When considering a variable-rate mortgage, some individuals will set standard payments (based on the same mortgage at a fixed-rate). This means that, should Prime drop and interest rates lower, they would end up paying more to the principal as opposed to paying interest. If the rates go up, they simply pay more interest instead of direct to the principal loan. Other variable-rate mortgage holders will simply allow their payments to drop with Prime Rate decreases, or increase should the rate go up.

Your Mortgage Term

Industry Standard: The benchmark amortization period is typically a 25-year period and is the standard that is used by majority of lenders when it comes to discussing mortgage products.

Shorter Amortization: A shorter amortization period will result in paying less interest overall during the life of your mortgage. Choosing this amortization schedule means you will also become mortgage-free faster and have access to your home equity sooner! However, if you choose to pay off your mortgage over a shorter time-frame, you will have higher payments per month.

Longer Amortization: A longer amortization period provides smaller monthly mortgage payments, which can make home ownership less daunting for first-time buyers as well as free up additional monthly cash flow for other bills or endeavors. A longer amortization can also often get you into your dream home sooner, due to utilizing standard mortgage payments versus accelerated.

Additional Considerations

When choosing a mortgage product, other considerations such as penalties can be important factors for deciding on a mortgage product. Beyond your rate and term, it is important to look at your options for things such as making extra payments or what your penalty is for breaking the mortgage.

It is easy to think that nothing will change throughout your 5-year mortgage term, but it is important to understand the penalties should something come up. Where variable rates typically charge three-years interest, a fixed rate mortgage uses an Interest Rate Differential (IRD) calculation. This is usually okay when the penalty is your contract rate versus the Benchmark rate. However, when penalties are based on the Benchmark rate (sometimes called the Bank of Canada rate), it is typically much higher than your contract rate, resulting in greater penalties.

In some cases, penalties for breaking a fixed mortgage can sometimes be two or three times higher than that of a variable-rate. While the interest rate is lower, lower penalties are sometimes best should anything happen down the line.

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