

Fixed *VS* Variable

Choosing between a variable or fixed mortgage can be one of the most significant decisions you will have to make when securing your mortgage. Although variable rate mortgages have historically provided more savings for borrowers, the peace of mind that comes with the cost certainty of a fixed rate mortgage may be more appealing to some.



What is a variable rate mortgage?

The interest rate of a variable-rate mortgage can vary throughout the mortgage term. Your mortgage lender will offer a rate tied to their prime rate (usually the Bank of Canada's Prime Rate). Typically the rate offered will be a discount off the prime rate, and you maintain that discount throughout the term of your mortgage. As the prime rate changes throughout the term, your rate will also change. For instance, if your rate is prime -0.60 , and prime is 4%, your rate would be 3.4%. If prime were to go up to 4.5%, your rate would also rise to 3.9%.

A rising or falling rate will affect your monthly mortgage payment differently depending on whether you have an adjustable or variable rate mortgage.

Adjustable Rate Mortgage: Your mortgage payment will rise or fall with the interest rates.

Variable Rate Mortgage: Your regular payments remain the same, but the amount of your payment that is distributed to principal and interest will change. This means that your amortization will fluctuate.

PROS:

Potential interest savings – Historically, clients have always paid less interest during a variable term rather than a fixed rate term

Smaller pre-payment penalties – If you decide to break your mortgage before the term is up (due to a move, refinance etc.), the penalty is only a three-month interest charge (note that 70% of Canadians break their mortgage term roughly around the 3.5-year mark)

Flexibility – You can lock into a fixed rate term, penalty-free, and anytime during your term.

CONS:

Higher risk – There is only one major con with a variable rate mortgage: risk. You will save on interest if rates stay roughly the same or decrease during your term. However, there is a risk that you could pay more than you would a fixed rate if mortgage rates rise

What is a fixed-rate mortgage?

The rate you have to start your mortgage is locked in and will remain the same for the entire term. This means you'll pay the same amount each month. Fixed rates are typically higher as you are paying for the certainty that your rate will not rise over the course of your mortgage term

PROS:

Cost certainty – With a fixed-rate mortgage, you have the peace of mind of not being concerned about the market and rising interest rates. Your rate and payment will remain the same throughout your term.

CONS:

Higher early pre-payment penalties – The penalties for ending your mortgage term early can be much higher than if you are in a variable rate mortgage. The penalty is either three months of interest OR an interest rate differential, whichever is higher. The interest rate differential (IRD) calculation is based on several variables, but a rule of thumb is that if the current rates are much lower than your rate when you break the term, the penalty will be very high. The bigger the spread, the higher the penalty. *note that not all lenders use the same calculation regarding the IRD penalty, so if this is a concern, we can help you find a lender with more favourable pre-payment penalties.

Restrictive – You are locked into the rate and payment for the entire term. This means you would have to pay a hefty penalty to refinance to take advantage of lower rates if they drop during your term.



Which option is better?

We are often asked which route is better, fixed or variable. We can always recommend a direction based on your current market, rates and financial situation. That being said, it is ultimately what you feel is best for you and what you are the most comfortable with.