



## Choosing between a fixed or variable mortgage loan

Should you choose a fixed or variable mortgage loan? It all depends on your tolerance to risk in the face of interest rate fluctuations.

What is the difference between a fixed-rate mortgage and a variable-rate mortgage?

- **Fixed-rate mortgage** A fixed-rate mortgage is a mortgage where the rate of interest is fixed for a specific period of time, generally known as the mortgage term. As time goes on, more of the mortgage payment goes toward the principal and less of the payment goes to the interest.
- **Variable rate mortgage** A variable-rate mortgage is a mortgage that has fixed payments, but the interest rate fluctuates with any changes in interest rates. If interest rates go down, more of the payment goes to principal and if interest rates go up, more of the payment goes toward the interest.

A fixed-rate mortgage charges a set rate of interest that does not change throughout the life of the loan. Although the amount of principal and interest paid each month varies from payment to payment, the total payment remains the same, which makes budgeting easy for homeowners.

The main advantage of a fixed-rate loan is that the borrower is protected from sudden and potentially significant increases in monthly mortgage payments if interest rates rise. It offers a high level of stability. When you lock in a mortgage at a fixed rate, you're locking in for the term of your mortgage so you will know, for each monthly mortgage payment, exactly how much is going to the interest and how much is going to the principal.

Experts say that a fixed-rate mortgage might bring more peace of mind to first-time homeowners, and that those who are further into their mortgage payments may like to try a variable rate to save more money.

The downside is that you can't take advantage of lower interest rates.

If you lose sleep worrying about the possibility of a .25 per cent increase in the interest rate or get stressed thinking about the impact on your monthly budget if your monthly mortgage payment changes, then a fixed-rate mortgage may be better for you.

With a variable-rate mortgage, your mortgage interest rate is based on the bank prime rate (which is the base interest rate from which the bank sets all the rest of its interest rates). Your interest rate will fluctuate as the bank prime goes up and down. Your monthly payments don't change. What may fluctuate is your interest rate. That means when rates go down, an increased amount of your payment will actually go to your principal, and less to interest. That means when rates go down, you're paying off your mortgage faster. But when interest rates increase, so does the portion of your payment that goes to interest and less going to cover the principal.

If risk is not as much of an issue, then a variable rate mortgage may be the way to go. Here is why:

Based on a detailed study completed by Moshe Arye Milevsky of interest rates from 1950 to 2000, consumers are better off, on average, financing a mortgage with a short-term, floating (prime) interest rate, compared to a long-term, fixed-rate mortgage.

Also, research by Canadian economic experts show that variable-rate mortgages hold more benefits to consumers the vast majority of the time. But that may not be right for everyone. Long-term stability has a price, but if you can't sleep, what good is the money?

Regardless of the loan that you select, choosing carefully will help you avoid costly mistakes.