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## 5 reasons to choose a variable-rate mortgage

### It is riskier, but it's a gamble that pays off

TORONTO One of the big decisions homeowners face is whether to choose a fixed- or variable-rate mortgage. Now may be the time to go variable.

A fixed-rate mortgage locks in an interest rate and the payment stays constant over the term. For new homeowners taking on a huge debt, this may help them sleep at night. You pay more, but you know exactly what the payment will be for your entire mortgage term.

With a variable-rate mortgage, the payment can fluctuate as interest rates rise or fall. For this reason, you usually get a better rate — to reflect the uncertainty and increased risk.

Although the central bank rate has not changed much over the past year — and is not expected to soon — lenders have been narrowing the gap between the two rates. That means it's a good time to consider a variable mortgage before the gap gets even smaller.

Here's an example of the potential savings. The best available five-year fixed rate stands at around 3.2 per cent and the five-year variable at 2.6 per cent, representing a 0.60 percentage point spread. You could save \$2,700 annually on a \$450,000 mortgage — the average price of a Toronto home — by going variable.

So, if you can sleep at night with the risk that your mortgage payment might change, a variable rate wins out. Here are some other factors in its favour:

1. Variable mortgages are historically cheaper. In the last 50 years, variable rates have been an average of 1 per cent cheaper than fixed rates, says James Laird of True North Mortgage. According to Bank of Montreal research, the last time fixed rates held advantage over variable rates was in the late 1980s.
2. Variable rates are near historical lows. The Bank of Canada has indicated it plans to keep rates low in the face of uncertainty over North American and European economies. The U.S. Federal Reserve has promised to keep interest rates low through 2013 and Canadian rates cannot diverge far from American ones. Some people in the mortgage industry are saying interest rates could fall further.
3. Variable rate penalties are typically lower. With a fixed mortgage, the penalty to break your mortgage is the greater of three months' interest or the Interest Rate Differential (IRD). A variable rate, on the other hand, is only subject to the three months' interest penalty. The much feared and little understood IRD penalty too often comes close to the cash savings you would earn with the new, lower interest rate, taking away much of the incentive to refinance. Most of

the 8 per cent of Canadians who refinanced in 2010 in fixed mortgages would have paid the higher IRD.

4. You can lock in at any time. If for whatever reason during your variable mortgage term you wish to lock in all or part of your mortgage at a fixed rate, you have the freedom to do so without any penalties or costs.

5. You start saving right away. Because of the current spread between fixed and variable rates, the savings are immediate. Even if interest rates rise, the increase would have to be big enough to wipe out the savings reaped at the beginning of the mortgage.

Variable rates are riskier, but it's a gamble that pays off. If you're still unsure, you could go half fixed and half variable, in which case you'll never be more than half wrong.

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