Adjustable Rate or Variable Rate?

What's the Difference?

As a homeowner or buyer, your mortgage decision should be based on several key criteria, including options that allow you to pay down your principal balance faster.

First, examine mortgage options that allow you to borrow as little as possible because the more you borrow the more you pay in interest costs. Second, look for a mortgage that has a competitive interest rate and favourable payment and prepayment terms. Third, pay off more principal at the beginning of your mortgage, it has a greater impact in shortening the amortization than waiting until later in the term.

Focusing on the above factors will go a long way to accomplishing the one goal that most homeowners have, paying their mortgage off faster.

One of the best mortgage products available to help homeowners pay their mortgage off faster is the "Adjustable Rate Mortgage" (ARM). This product offers the stability of a fixed rate mortgage while also taking advantage of today's low prime interest rate. Commonly referred to as the "ARM", many consumers confuse the Adjustable Rate Mortgage (ARM) with a Variable Rate Mortgage (VRM). Even though both mortgages can have similar rates, based on the prime rate, some significant differences make the ARM a better product when it comes to paying your mortgage down faster.

Possibly the most important feature to consider when selecting an ARM is how the payment is calculated. The payment on the ARM you select should be based on the 3 or 5 year fixed rate. By selecting this type of payment structure, you can enjoy the peace of mind of having a consistent payment amount. Additionally, once the Prime less 0.75% is satisfied from each payment, the extra is applied directly to principal. This allocation has the dramatic effect of reducing the amortization faster, especially in the early stages of a mortgage, and thereby reducing the amount of interest you pay on the mortgage.

The other little known but significant benefit to a higher fixed payment is that you may be borrowing less money compared to choosing a Variable Rate Mortgage where the payment is determined by prime less 0.75% and will fluctuate with each change in the prime rate. If you are purchasing with less than 25% down payment and you choose a Variable Rate Mortgage, CMHC and Genworth, (high ratio mortgage insurance companies) add an additional 0.25% to the insurance premium. This is because there is an increased risk of frequent payment fluctuations with a VRM and means you are borrowing more money than you need to! On a $200,000 mortgage, this could be an additional $500 insurance premium you pay to CMHC or Genworth with interest and could represent extra and unnecessary payments just by choosing the wrong mortgage product.

Finally, choose an ARM that allows you to make accelerated bi-weekly or weekly payments. Making payments more frequently can reduce the amortization of the mortgage faster. Today, most people get paid weekly or bi-weekly so why not match your payday with your mortgage payment day. It keeps the cash flow manageable and puts you well on your way to "Paying Your Mortgage off Faster".

For a Cervus Adjustable Rate Mortgage call:

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