Canadians: Are You Making These 3 Huge Mortgage Mistakes?

Description

With low interest rates and a predicted dip in house prices upcoming, it's little wonder why many stable Canadians are looking to buy a house.

Although I'd argue real estate isn't quite the investment many bulls make out to be, there are still many compelling reasons why you want to own your own home. There's the pride of ownership factor, something renters will just never understand. Owning your own home can be an effective way to build up some savings, and you can really minimize your housing expenses once the place is paid off.

While Canadians are pretty good at the buying part of real estate, one place we struggle with is the mortgage. With dozens of competitors in the space and seemingly an endless list of terms and conditions, it's easy to see why folks get confused. Just a couple mortgage mistakes can cost you tens — or even hundreds — of thousands of dollars over the life of your loan.

Let's take a closer look at three of the most common mortgage mistakes you might make before buying your next place.

Not shopping around

It used to be difficult for consumers to shop around for a mortgage. Most would go into their bank, fill out a few forms, and hope for the best. Then mortgage brokers emerged, who worked with dozens of lenders to get the best deal.

Things are much different in 2020. Many folks use the internet at the beginning of their mortgage search, scouring various rate comparison websites for the best deal in their area. This has brought rates down significantly as more traditional lenders know they have to be competitive to get business.

A 1% difference in rate might not seem like much, but it really adds up over time. If you have a $300,000 mortgage at a 2.5% interest rate, you'll pay a total of $103,169 in interest over a standard 25-year amortization. If your rate goes up to 3.5%, you'll pay $149,343 in total interest. Also, a $46,000 difference over 25 years works out to almost $2,000 per year or more than $150 per month. This mortgage mistake really adds up.

Go variable, not fixed

Smarter people than I have crunched the numbers, and the results are in. It almost always makes sense to take a variable rate versus a fixed rate.

The reasoning is simple. Usually you can qualify for a significant discount versus the prime rate if you go variable. A variable rate is often 0.5%-1% lower than a comparable fixed rate. Interest rates have to rise substantially for the total cost of a variable rate to exceed a fixed rate. That could happen going forward, but nobody knows.

One note of caution, however. As interest rates have gone down, the gap between variable and fixed rates has decreased as well. The difference today with many lenders is less than 0.5% on a five-year term. Perhaps today might favour fixed rates.

Paying it down early

Wait, what? Isn't paying down your debt a good thing?

Well, it depends. We must remember that on a 2.5% fixed-rate mortgage, you've locked in a 2.5% return by paying down the mortgage early. It's highly likely an investment in the stock market will do better over the long term.

Say you can afford an extra $500 per month to put down on your mortgage. Instead, you put it in an excellent stock like mortgage provider **First National Financial** (TSX:FN), which has posted an annual return of 18.21% (including reinvested dividends) since 2008. We'll be conservative, however, and assume First National returns just 8% going forward. That's barely more than the company's 6.3% dividend yield today.

After 25 years earning 8% annually, a $500 per month investment would be worth a hair over $514,000. Total interest paid on a $300,000 mortgage, meanwhile, would be approximately $103,000.

As you can see, it makes total sense to forgo paying off the mortgage early and put that cash into the stock market instead.

The bottom line

Making these three mortgage mistakes can really impact your overall financial health. We're talking hundreds of thousands of dollars in missed opportunities.

If you're looking to buy a house anytime soon, make sure you're making smart decisions. With the number of lenders out there today it's best to find a mortgage that will ultimately make you richer.

CATEGORY

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