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The ideal mortgage

If you're in the market for a mortgage, you're in luck: you've never had more choice. Here's how to pick the right one.

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Let's face it, shopping for a mortgage has all the curb appeal of a pile of bricks. Who wants to compare interest rates when you could be discovering your next dream home? But picking the right mortgage is just as important as finding the perfect place to live. After all, house hunting can be intoxicating, but once the buzz wears off you still have to pay for the thing.

The right mortgage can help you pay less for your home, and pay it off faster. But to do so, your mortgage has to deliver appropriate payment options, the flexibility you need, and the right lender to work with. The wrong mortgage? Well, you could end up paying thousands more than you have to, and you could be stuck with it for years longer than you'd like. The good news is your mortgage options have never been better. We know all that choice can be confusing, but don't worry—we can help.

The first question you'll face is whether to lock in at a fixed rate or go with a variable mortgage, where the interest on the loan rises and falls with the prime rate. The choice you make depends on what's important to you. For instance, with a fixed-rate mortgage, your interest rate and monthly payments will stay the same for the entire term of your loan. (Most people get a three- or five-year term, but you can lock in for 10 years or more.) At the end of the term you'll renegotiate your rate as part of the renewal process.

The main benefit of fixed-rate mortgages is peace of mind: If rates rise, that won't affect you. But if the prime rate drops it also means you won't enjoy the savings. So who should consider them? Fixed-rate mortgages are a good bet if you want the ability to plan your monthly costs precisely. This is particularly useful if your cash flow is limited, or you are a real estate investor. "If you don't like the idea that your mortgage payment will change as interest rates fluctuate, then lock in for a fixed rate," says Rona Birenbaum, a fee-only adviser with Caring for Clients in Toronto. "Plus it will make life more comfortable for you if your income goes up over the term of the mortgage."

Variable-rate mortgages have more risk, but they also have advantages. Variable-rate mortgages usually offer a lower initial rate than you'd get on a fixed-rate mortgage, and you stand to benefit if the prime rate drops. The risk, of course, comes when rates rise. If that happens, more of each payment will go towards paying interest, rather than paying down the principal. If rates rise sharply, your payment amount could even jump up. But there are ways protect yourself against this. "I always recommend to my clients that they establish a mortgage payment plan in which they make slightly higher payments than they have to," says Birenbaum. Because you're paying more than the minimum already, if the payment amount goes up, it doesn't require a cash flow adjustment to your budget.

History presents a useful guide as to what type of mortgage to choose. "In recent years you would have been better off in variable-rate mortgages," says Jason Heath, a fee-only financial planner with Objective Financial Partners in Toronto. "But that's because we've had falling mortgage rates over the last 30 years." Today, rates are low and they will likely rise, so there may be benefits to locking in, too.

Keep in mind that there are many other important considerations beyond the rate you pay. Ask yourself: Is the mortgage transferable? Are there prepayment privileges? How much are the fees for breaking the mortgage? Or should you even have a mortgage at all? That last question might surprise you, but if the amount owing on your mortgage is small—$75,000 or less, say—a smarter option might be to use a secured line of credit (SLOC) instead. These loans are similar to a variable-rate mortgage in that the rate is based on prime and can fluctuate, but with a SLOC, you can pay off the loan faster without penalty. "Just make sure you remain disciplined when it comes to your payments," says Birenbaum. "Don't just let them ride. Pay them down consistently."

Finally, give some thought to how many extra mortgage payments you can make each year. If you think your salary may go up during the term of your mortgage, then opt for one that allows you to chip away at your principal with extra payments. In this case, open mortgages are a good option because they can be prepaid at any time, without penalty.

You don't have the same flexibility with closed mortgages. In exchange for a better initial rate, closed mortgages limit your ability to make extra payments and cost more to break. That last factor can cost you thousands if you decide to break your mortgage or you have to sell your house.

Remember, too, that if you have equity in your home, you can arrange access to more credit than the amount outstanding on your mortgage. You only pay interest on what you actually borrow—a nice arrangement if you ever need money for maintenance, renovations or emergencies.

Whichever type of mortgage you pick, keep this one tip in mind: "Always try to choose an aggressive, but affordable mortgage," says Birenbaum. "That will allow you to keep your other financial goals on track." At the end of the day, there's no one right mortgage for everyone. So make sure to sit down with your financial adviser to discuss your goals and personal situation before you make your choice.

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