Locking in mortgage an inflation hedge

MERRICK WEALTH

By Peter Merrick

A few years ago, I had a conversation with a 90-year-old gentleman who held an annuity plan that paid 17 per cent per year on his investment. Each year the insurance company that issued the annuity requested proof that he was still alive because they wanted to stop payments.

When I asked why he had taken $300,000 and invested it into a locked-in 17 per cent annuity back in 1981, his response was, "life." He had been around long enough to see interest rates averaging six per cent for most of his life, and he knew over time that interest rates would go down just as they went up.

As Canadian interest rates drop to historic lows, most people are trying to understand the best way to save money on their mortgage.

Consumers are starting to wonder how to take advantage of historically low interest rates, by either securing a variable rate as low as 3.3 per cent or locking into a fixed 10-year rate at four per cent, to provide security against future increased interest rates and inflation.

As the Canadian government increases its debt threefold by printing billions of dollars to create economic stability, consumers are forgetting that when production output doesn't tie into every dollar that enters the Canadian marketplace, high inflation becomes a risk. And inflation is directly tied to increased mortgage rates.

Textbooks and economic charts all show the trend of interest rates moving up and down over the decades through bull and bear markets. But not since the late 1920s have we seen greed and lack of regulation take such a deep cut into the western market system. Many feel that it took the Second World War to pull our economy out of that slump.

Now is the time to seriously consider locking in to a fixed mortgage, to take advantage of the lowest rates in Canadian history; For example, with a $500,000 mortgage at an interest rate of four per cent, amortized over 10 years, your monthly payment is approximately $5,054.44 and your total interest paid is $106,616.

Signing a variable mortgage and trying to play the rate game by holding on until rates move up may sound good. But historically, as variable rates start to move up, so do fixed rates, thus, waiting too long to lock into a mortgage as rates start to climb can be costly.

With a $500,000 mortgage at an interest rate of 12 per cent, amortized over 10 years, your monthly payment is approximately $7,090.14 and your total interest paid is $351,343.

The word on the street is that rates are unlikely to drop any further. So is now the right time to move to a fixed rate? It all depends on an individual's circumstances, but understanding the economic realities should also be part of the equation.

For the first-time homebuyer looking for a mortgage of $300,000 or more, it's advisable to lock in to a long-term mortgage. For the majority of homeowners who hold a mortgage for less than $115,000 it is advisable you stick with the variable rate for the moment.

This is because on a three-year fixed rate mortgage, given best rate achievable the cost to break the mortgage in penalties may not be worth the savings. If you believe a fixed rate is a good fit, you need to take into consideration what the market may be like at the time of the next renewal.

A three-year mortgage can leave one looking at a renewal just when the economy starts to get into full recovery, meaning a higher interest rate down the road.

It's important to note that the last time rates were this low was in the 1990's, and if 20-year cycles prove to be correct, it won't be until 2020 that lower rates come around again. If you're able to maintain your financial stability, it's worth considering locking into a 10-year fixed mortgage.

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