Open vs. closed mortgages: Which is right for you?

Choosing a mortgage is one of the most important financial decisions you'll make. Open vs. closed mortgages. Fixed vs. variable rates. Amortization period vs. term. It can be overwhelming. Before you bury your head under the covers, read this article to help you make sense of it all. Then ask your mortgage broker if you have any follow-up questions.

Amortization vs. term

A mortgage has both an amortization period and a term:

- The **amortization period** is the number of years it would take to repay the entire amount of the mortgage. Typically this is 25 or 30 years, but there are ways to reduce the time it takes to pay down a mortgage, like:
    - Increasing your payment amount. Even a small increase makes a big difference.
    - Taking advantage of your prepayment options to make a lump sum payment.
    - Increasing your payment frequency. The more often you pay against your principal amount, the less interest can be charged against it.
- The **term** is a shorter period of time in which you are committed to a specific interest rate and lender. For example, your bank might offer mortgages with 1-year, 2-year or 3-year terms. When the term is up, you can pay the balance owed, renegotiate the rate, and renew or change lenders. You will likely renew your term several times over the life of the mortgage until the full amount is paid. There are two types of terms—closed and open.

In short, the amortization period is made up of several terms.

Closed mortgage	Open mortgage
A closed mortgage can't be renegotiated or repaid in full before its term is up, or there will be prepayment charges. Some closed mortgages have prepayment options that, once a year, allow you to make a lump sum payment against the principal amount. Closed mortgages tend to have lower interest rates because you are committing to the lender for a set amount of time. A closed mortgage might be right for you if you: • Want a lower interest rate to better manage your payments. • Plan to keep your property for more than a year.	An open mortgage can be repaid at any time during the term without a prepayment charge. Open mortgages usually offer higher interest rates in return for flexibility. An open mortgage might be right for you if you: • Plan to sell your property within 12 months. • Are going to pay off some or all of the mortgage amount in the near future. • Need short-term cash to invest in a business or start-up.

So, what about those prepayment charges? If you're not sure you want to lock in with a closed mortgage, ask your mortgage broker how the mortgage penalties are calculated. Sometimes the penalties are less money than the increase in interest you will pay with an open mortgage. Your mortgage broker can help you run the numbers.

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Fixed vs. variable mortgage rates

Deciding between an open or closed term is not the only factor to consider when applying for a mortgage. Interest rates can be variable or fixed. Lenders will offer various combinations of open and closed, variable and fixed-rate mortgages.

Fixed rate	Variable rate
A fixed rate is set for the entire term of the mortgage. Fixed rates tend to be higher than variable rates because you get the stability of that rate for your mortgage term, even if interest rates go up. A fixed rate might be right for you if you: • Believe interest rates are going to go up during your mortgage term. • Want peace of mind, knowing that your payments won't change. • Prefer a stable rate to help you budget accurately.	A variable rate increases or decreases when the prime interest rate does. Variable rates tend to be lower than fixed rates because they fluctuate. You are taking a risk that interest rates won't increase suddenly. If the rates decrease, more of your payment will then be applied to your principal, or if rates increase less is paid to the principal. With a variable rate, you can choose fixed or fluctuating payments. • A fixed payment means each mortgage payment is the same amount for the term of the mortgage. The amount going towards the principal of your mortgage depends on the interest rate. • Fluctuating payments will cause your payment to go up and down with the interest rate, but the amount going toward your principal will be the same. A variable rate might be right for you if you: • Believe interest rates are going to remain stable for a while. • Are willing to monitor interest rates for changes. • Can absorb a possible rate increase. • Are comfortable with payments that could change from time to time.

Talk to your mortgage broker about the mortgage options available to you. They'll help you weigh the pros and cons so that you can make an educated decision on what works best for you and your situation.

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