

THE MORTGAGE DILEMMA

Buy now and take advantage of low mortgage rates – or wait to see if home prices drop? Do the math, says Kevin Lutz, and you will come to the right conclusion – the one that saves you money.



Kevin Lutz,
regional manager,
mortgage specialist,
Royal Bank of Canada

If you are like many potential homebuyers today, you are wondering whether home prices are going to decrease, by how much and when. You may also be wondering whether to buy now to take advantage of ultra-low mortgage rates.

Your choices lead to weighing the benefits of low mortgage rates now versus waiting for possible decreases in home prices. In other words, will a low mortgage rate now benefit you more than a potential decrease in home prices – and how much would home prices need to decrease to offset you paying potentially higher

mortgage rates? Not easy to predict, and not an easy decision, but I'll try to help with some calculations.

First, to help you understand the increased interest costs when mortgage rates increase, opposite is a comparison between three mortgages of \$350,000, assuming a five-year fixed term, 35-year amortization and rate increases of one-half percent for each calculation.

The bottom line here is that you will pay \$17,101.39 more interest during the first five years of your mortgage alone if the mortgage rate is increased by one per cent. Your overall payment per month is also \$209.12 more.

This leads to a second calculation/consideration to help you decide whether to wait – and that is your purchasing power, which is based directly on the size of the mortgage for which you qualify. When mortgage rates increase, you qualify for a lower mortgage amount and thus a lower purchase price. To what extent could you be affected?

Let's assume that you meet with a mortgage specialist today and after all your financial information is considered, you qualify for a mortgage of \$350,000. (As above, you have chosen a five-year term



at 3.75 per cent and a 35-year amortization.) Now consider you decide to wait to buy and interest rates increase by a total of one per cent to 4.75 per cent. The outcome is that you would now qualify for approximately \$43,000 less mortgage, or \$307,000. Therefore, the purchase price of a home you qualify for is reduced accordingly. Most importantly though, you would need to rely on an equivalent (or better) percentage decrease in the purchase price of the home to offset the interest rate increases. And don't forget that you might be paying rent while waiting, further compounding the home price reduction factor.

A compelling reason to take advantage of today's low mortgage rates is to understand the effects of increased mortgage rates on your purchasing power. A sure thing right now is that mortgage rates are (again) close to all time lows. An unknown factor is where house prices are headed. To help you decide using your own specific information, seek the advice of your mortgage specialist and realtor. ■

Comparison of mortgage rates

Mortgage Amount	\$350,000	\$350,000	\$350,000
Amortization	35 Years	35 Years	35 Years
Interest Rate	3.75%	4.25%	4.75%
Interest Term	5 Years	5 Years	5 Years
Rate Type	Fixed	Fixed	Fixed
Payment Frequency	Monthly	Monthly	Monthly
Payment Amount	1,491.70	1,594.72	1,700.82
Term Interest Cost	\$62,747.73	\$71,288.38	\$79,849.12
Amortization Interest Cost	\$276,509.67	\$319,774.07	\$364,341.76

Source: RBC mortgage calculator at www.rbcroyalbank.com.*

* In this chart we assume the following: (i) a constant interest rate throughout the amortization period, (ii) interest is compounded semi-annually for fixed interest rates and each payment period for variable interest rates; and (iii) the payment schedule you selected is maintained with no additional payments or skipped payments, unless selected by you. Royal Bank of Canada does not make any express or implied warranties or representations with respect to any information or results in connection with these calculations. Royal Bank of Canada will not be liable for any losses or damages arising from any errors or omissions in any information or results, or any action or decision made by you in reliance on any information or results.

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