Is a Home Your Best Savings Vehicle?

The most meaningful advantages of owning a home are not really financial in nature. You can pursue hobbies you enjoy, decorate as you wish and keep a pet of your choosing—all without the approval of a landlord.

More often than not, a real estate purchase involves a lifestyle decision, so it's a nice bonus that paying a mortgage promotes savings discipline and can actually help you build wealth over time.

Compelled to Save

Making payments on a fully amortizing mortgage requires you to set aside money every month, because a part of each installment is allocated to the repayment of the borrowed principal.

Each month, both the loan balance and the amount of interest due will drop, and the principal portion of the payment will increase until it is paid off. See the following table for an example of how principal payments grow and savings accelerate over time with a $300,000 mortgage.

5-year fixed payment at 4.0% = $1,578.06 (amortized over 25 years)				
	Principal	Interest	% Added to savings	Loan amount reduced / Equity increased
Initial payment:	586.29	991.77	37%	
After 5 years:	714.69	863.37	45%	**$38,838**
After 10 years:	871.20	706.86	55%	**$86,182**
After 15 years:	1,061.99	516.07	67%	**$143,893**

Shorter Terms Get You There Faster

The typical amortization period in Canada is 25 years. Some borrowers, especially first-time buyers, stretch the amortization period to 35 years for more affordable monthly payments or to qualify for larger loan amounts in areas with more expensive housing. Of course, that choice significantly reduces the amount of equity they can earn in the early years of the loan.

Those who can afford a larger monthly payment might want to consider a shorter 10- or 15-year amortization period and save thousands of dollars in interest over the life of the loan. Also, a much higher percentage of each payment goes toward principal from day one, so homeowners can build up savings more rapidly.

Today's low rates make a shorter repayment schedule realistic for a greater number of buyers, but it's also a great option for refinancing homeowners who want to stay on track to pay off their mortgage before retirement.

{ Property values can fluctuate due to changes in market conditions, but many homeowners have benefited from long-term property appreciation, and the potential remains for others to profit in the future. In fact, the longer you stay in your home the more likely it is that market increases will add to the savings you accumulate. }

Choose the Right Time to **Retire Your Mortgage**

Maybe you dream about becoming debt-free and living it up during retirement. If so, prepaying your mortgage could be a worthwhile endeavor. Are you fortunate enough to have extra cash flow each month or a larger lump sum you don't need for regular living expenses?

Prepay for Peace of Mind

- Every payment that reduces principal is the same as a guaranteed and risk-free investment return equal to the interest rate on the mortgage. Therefore, it can be more beneficial to devote excess cash toward paying down a mortgage when the interest rate is higher than the return that could be earned with new investments.
- For many Canadians, especially those nearing retirement, it makes sense to pay down mortgage debt now because the market returns for the safest investments, such as government bonds and guaranteed investment certificates (GICs), have fallen to the lowest point in many decades—yielding only 1 to 3% or less*.

Source: Bank of Canada

{ More than 2/3 of Canadians list becoming debt-free among their top financial priorities. }

Source: The Globe and Mail, October 2010

On the Other Hand

- It's better to eliminate higher-interest credit debt before making extra mortgage payments. You may also want to wait until your employment situation and income are relatively stable and you have set aside an adequate savings cushion for emergencies.
- When it comes to building a diversified retirement portfolio, it may not be wise for all workers to forego the tax benefits associated with investments in an RRSP for the sake of prepaying a mortgage.
- Borrowers who want to pay off their mortgage more quickly can ask their lender about accelerated weekly or biweekly payment options. They should also find out how much extra they can pay each year without triggering prepayment penalties. In many cases, they will be allowed to make at least one or two months' worth of additional payments against the principal each year, or pay a larger portion (up to 20% of the mortgage) annually using surplus funds such as a bonus or tax refund.

Diminishing Returns for **Stashed Cash**

Government of Canada Benchmark Bond Yields:	
2-year	1.41%
5-year	2.00%
10-year	2.83%

Source: Bank of Canada, November 1, 2010