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With mortgage rates dropping, it's strategy time

By Rob Carrick
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Mortgage broker Robert McLister says variable-rate mortgages won't fall to pre-crisis lows any time soon

It was a little less than a year ago that the global financial crisis began to hit home, which is to say that mortgage rates spiked higher.

Now, the cost of mortgages is coming down. If you're buying a home or renewing a mortgage, it's time to review your options.

Fixed-rate mortgages declined a little last week, but the most dramatic changes can be seen in variable-rate mortgages. For the first time in almost a year, it's possible to get a variable-rate mortgage at the prime rate used by most major financial institutions, which is currently 2.25 per cent.

Pre-crisis, variable-rate mortgages came with discounts that ranged from 0.75 percentage points to as much as 0.9 points off prime. By late last fall, crisis conditions prompted lenders to start charging prime plus a full percentage point or more. Now, some lenders are starting to unwind their crisis-rate premiums.

"Variable-rate mortgages are all over the map right now," said Gary Siegle, regional manager with the mortgage brokerage firm Invis Inc. in Calgary. "We're seeing them right in the area of prime with some lenders."

An example of a variable-rate mortgage at prime: ResMor Trust, a small player that deals through mortgage brokers, is offering four-year variable-rate mortgages at prime in all provinces except Quebec. The catch: You have to have your mortgage approved by Sept. 30 and close the purchase within 45 days.

Can variable-rate mortgages fall back to their pre-crisis lows any time soon?

"Definitely, 100 per cent, no," said Robert McLister, a mortgage broker and author of the Canadian Mortgage Trends blog (canadianmortgagetrends.com). "Could they get a little below prime? Definitely."

Many home buyers choose a five-year term when selecting a fixed-rate mortgage. But mortgage broker Robert McLister says the three-year term is worth looking at as well because it offers a low rate plus several years of rate security. Here's how three- and five-year mortgage rates have compared in the past couple of years. Note: these are posted rates that are commonly discounted.

	2008	2009

	Jan.	April	July	Oct.	Jan.	April	July	Current
3-Year	7.40%	7%	7%	7.05%	5.75%	4.15%	4.55%	4.35%
5-Year	7.39%	6.99%	7.15%	7.20%	5.79%	5.25%	5.85%	5.49%

Source: Bank of Canada, Cannex

Okay, it's strategy time. With prime at 2.25 per cent and fully discounted five-year fixed-rate mortgages going for something in the area of 3.9 to 4.1 per cent, you're got some thinking to do if you're buying a home or renewing a mortgage.

The variable rate looks tempting. Sure, the prime is going to rise in the medium term, but it's expected to stay put until next spring at least. Even when prime does move higher, it will have to increase by roughly 1.75 percentage points to get to where today's five-year mortgages are.

"The risk is obviously that rates go up a lot more," Mr. McLister warned. "Rates went down four percentage points from December, 2007, through April, 2009. They could easily go up four - why not?"

Variable-rate mortgages allow you to lock into a fixed-rate mortgage, so there's no reason why you have to ride interest rates all the way up. Still, you have to recognize that fixed-rate mortgages could be significantly more expensive by the time you decide to lock in.

An academic study of rates between 1950 and 2007 found variable-rate mortgages were the money-saving choice over five-year fixed-rate mortgages 89 per cent of the time. If you're willing to ride rates higher for a while in hopes of longer-term savings on interest costs, then consider a possible approach suggested by Mr. McLister.

Instead of arranging a variable-rate mortgage now, go for a one-year fixed-rate mortgage. Then, when you're renewing in one year's time, you'll move into a variable-rate mortgage that will ideally have a rate that is discounted below prime.

Fully discounted one-year closed mortgages today go for about 2.55 per cent, so you're not paying much of a penalty at all compared with what variable-rate mortgages are pegged at right now.

Another suggestion from Mr. McLister is to consider a three-year mortgage, which offers an attractive blend of low rates and security against interest rate surges. Three-year mortgage typically go for around 3.39 per cent on a fully discounted basis, but he knew of one small lender offering 2.9 per cent through the mortgage broker channel.

The case for going with a five-year fixed rate is that rates are very cheap by historical standards. Rates were a little bit lower last spring, but they're not as high as they were a month or two ago thanks to a pullback in bond yields that has trickled down to fixed-rate mortgages.

Mr. Siegle said over half of his firm's clients are locking into a fixed-rate mortgage right now. "You can't ever time the bottom of the market, but are these good rates that you can be comfortable with? A lot of people are saying, 'yeah, they are.'"