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COMMENT

Fix or float is the big mortgage question as BoC rate cuts near

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Next Wednesday could be a game-changer for family budgets everywhere. If not then, mark your calendars for July 24.

On one of those dates, financial markets believe the Bank of Canada will make its first interest rate cut in more than four years. The anticipated move would be financial Aspirin for a lot of borrowing headaches, and it comes after what Rosenberg Research founder David Rosenberg calls the "sharpest three-year interest rate surge in four decades."

For those with adjustable-rate mortgages, cuts mean the savings should soon start adding up. On a conference call Tuesday, Scotiabank estimated that a 25-basis-point drop in its prime rate could skim about $100 off monthly payments for big city borrowers.

As mortgage shoppers are increasingly bombarded with headlines about looming rate cuts, they're bound to revisit the classic conundrum: to fix or to float?

Currently, it's trendy to snag three-year fixed mortgages, as fewer souls are daring to commit to the antiquated five-year terms ahead of a presumed rate-cut cycle.

Once the BoC pulls the trigger, however, floating rates should steal the spotlight. But is rolling the dice with them worth the thrill?

Forecasting rate trajectories is often a fool's errand, but there's one thing we can rely on: Economies are cyclical, and inflation ultimately succumbs to higher interest rates.

Given current mortgage rates and the latest forward rate expectations, as tracked by CanDeal DNA, the numbers lean favourably toward variables when assessing potential interest savings alone.

Should market rate forecasts hit near the bull's-eye (a rare spectacle, admittedly), a borrower with a standard $500,000 variable mortgage could theoretically save about $6,000 of interest over five years versus an old-school five-year fixed.

This holds whether you're dealing with an insured or uninsured mortgage, as the gap between fixed and variable rates hovers around 80 basis points for both.

Given variable discount improvements and the imminence of potential rate cuts, variables even project to outperform the long-standing term of choice, the three-year fixed.

Speaking of which, three-year mortgages remain the best values among fixed rates. You're guaranteed to pay more for the first three years than a longer term, but being able to reset to a cheaper rate in 2027 can put you well ahead of a five-year fixed, for example.

Two side notes: Lower rates in 2027 obviously aren't guaranteed, and five-year fixed rates make it easier for some people to qualify due to how the government's mortgage stress test works.

A three-year also gives you more flexibility to refinance or break the mortgage sooner without a hefty prepayment penalty. That's why so many people have been boarding the three-year train. Albeit, variables have a friendly three-month interest charge if broken early.

People also ask about one- and two-year terms. At the moment, they're not much of a bargain unless you're after short-term financing, given their upfront rates are notably higher.

Of course, just because a particular term looks good on paper doesn't mean it'll actually pan out. Risk tolerance plays a significant role, too. Those on a tighter budget should seriously think about locking in, at least partially.

This might involve signing up for a fixed term of three years or longer, or exploring a hybrid setup — part of your loan fixed, part variable. You get to pick the mix; it doesn't need to be a 50/50 fixed/variable split. To find a cost-effective hybrid, Scotiabank-approved brokers, TD, BMO and RBC are among the best bets.

OTHER NUGGETS

- Investors Group believes 30-year amortizations give borrowers key flexibility to funnel cash to more productive uses than their mortgage. "We still have clients benefiting from rates in the two per cent range. For those clients, we're not recommending that they speed up mortgage payments," says Alana Riley, head of mortgage, insurance and banking at IG Wealth Management. "If individuals are struggling with cash flow, 30-year amortizations may provide an opportunity to invest in an RRSP or RESP and get the tax benefit," she says. "Although, in the past few years, we've seen paying down other credit become a priority before investing in a registered account."
- Oxley Real Estate founder Gillian Oxley predicts "With a rate cut — or two, if we have one in June or July and one in the fall — the improved confidence will lead to price stability across the market."
- For self-employed mortgage applicants, prime lenders routinely ask for the last two years of tax documents and take a two-year average of the reported income, or use the lower of the two years if your income is descending. For folks who didn't report a lot of income in 2023, but did in the two prior years, some lenders still allow the use of 2021 and 2022 tax returns up until June 15, the 2023 tax-filing deadline for self-employed individuals. Other lenders allow them until July 15, for example. For self-employed mortgage applicants, these deadlines can significantly impact how much they qualify for.
- Wowa.ca has a capital gains calculator to estimate how much more Ottawa will milk property sellers after the June 24 capital gains tax grab.

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