

## UNDERSTANDING MORTGAGE RATES

There seems to be a large degree of confusion about how mortgage rates are set in Canada. While considerable media attention is focused on movements in the Bank of Canada's Overnight Rate (otherwise known as the *Headline* interest rate), such analysis provides limited insight into certain segments of the mortgage market. In order to gain a more comprehensive understanding of what drives mortgage rates, it is important to make a distinction between the determination of *Fixed* versus *Variable* mortgage rates.

Variable mortgage rates are tied to the bank's *Prime* lending rate, which is directly linked to the Bank of Canada's Overnight Rate. In most circumstances, the Prime lending rate will change in the same direction and by the same amount, as any change to the Overnight Rate. Therefore, if the Bank of Canada announces a decrease in the Overnight Rate by one quarter of 1%, then you can expect most Variable rate mortgages to also drop by one quarter of 1%.

Fixed mortgage rates, in contrast, are determined by yields in the bond market, and do not fluctuate with changes in the Prime rate. Therefore, while the Central Bank's decisions do impact *Variable* rate mortgages, these decisions do not influence *Fixed* mortgage rates. It is not uncommon, in fact, to see Fixed mortgage rates increase while the Prime rate decreases, and vice versa. So unless you are shopping for a Variable rate mortgage, don't pay attention to the hype surrounding interest rate announcements by the Bank of Canada.

In order to determine where Fixed rate mortgages are headed, it is useful to study changes in the bond market. Consistent increases or decreases in the yield on the bond that corresponds with your mortgage term should give an indication of where your

rate is headed. For example, if you are interested in a 5-year mortgage rate then track the equivalent 5-year Government of Canada bond; if you are interested in a 1-year mortgage rate then track the equivalent 1-year Government of Canada bond.

Given the current economic climate, consisting of historically low Government of Canada bond yields and Fixed mortgage rates, **now** is the ideal time for prospective homeowners to obtain a Pre-Approval. Not only does a Pre-Approval secure your financing in advance of the home search process, but it also protects you against potential future increases in interest rates. This is accomplished through a "*Rate Hold*", which is typically valid for 90-120 days. Therefore, if rates increase while you search for your ideal home, you can rest assured that you still have access to financing at your Pre-Approved rate. However, if rates decrease during the interim period, your rate will automatically float down to the lower rate.

Please feel free to contact me if you are interested in applying for a mortgage Pre-Approval. I am happy to answer any questions, and there is no fee or obligation involved in the process.

Best Regards,

Justin

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