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Homeowners pushed to lock in mortgage rates

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TORONTO - Canadian banks are trying to convince consumers to lock in their mortgage rates because more than 20 per cent of the home loans they have negotiated have become unprofitable, according to industry sources.

The push has come after the banks cut the discount they offered to consumers with variable-rate products tied to the prime lending rate. Two weeks ago, a consumer could get a variable rate product at 0.60 percentage points below prime; today it is one percentage point above prime.

"Banks are scaring people and those people are calling us asking whether they should lock in," said Vince Gaetano, a vice-president with Monster Mortgage, a mortgage brokerage firm.

His advice is pretty emphatic. Anybody with a mortgage negotiated in the past two years would be out of their mind to lock in to, say, a five-year term, he said. They would be going from a rate as low as 3.35 per cent to 5.79 per cent. Lines of credit previously negotiated at a rate below prime are also still valid.

"If you've got a mortgage rate negotiated below prime, you have a dinosaur. It doesn't exist anywhere. You should hold onto until the end of the term," said Gaetano. "The banks propped up all their rates 160 basis points because they knew the Bank of Canada would be lowering rates."

Last week, the Bank of Canada lowered interest rates by 50 basis points only to see the major banks cut their prime lending rate by half that amount. After some pressure, most of the banks cut their prime lending rate by the full 50 basis points.

Joan Dal Bianco, vice-president of real estate-secured lending with Toronto-Dominion Bank, said the banks were reluctant to pass on the full 50-point rate cut because they were losing money on variable-rate products.

"At the prime minus rates we were basically earning zero or negative. We kept holding off (cutting the discount)," said Dal Bianco, adding that in the past year 50 per cent of her bank's new mortgages were variable-rate products.

With a cost of funds generally above four per cent because of the lack of liquidity in the market, the mortgages previously negotiated ended up below water after the latest rate cut.

Prime is now 4.25 per cent at TD but two weeks ago the bank was offering a variable rate of 60 basis points below prime, meaning the consumer was borrowing at 3.65 per cent.

For those now entering the housing market, the rate is 5.25 per cent for a variable rate product but Dal Bianco said that might not be high enough. "We are not making much money on those if anything." she said.

The move into variable mortgages tied to prime has come in the last five year with many of the banks promoting products that allow consumers to float with prime but lock in a rate at any time during the term of their mortgage.

The Canadian Association of Accredited Mortgage Professionals says, as of 2007, 21 per cent of mortgages were variable rate, 72 per cent were fixed rate and seven per cent were a mix of the two.

Asked whether the banks are actively encouraging consumers to convert variable rate products, Dal Bianco said that hasn't happened. "We are making sure (staff) have the right conversations if people are really nervous and do not want to see their payment moving."

Another key question going forward for consumers will be whether the prime rate at the banks will continue to move with Bank of Canada's rate and nobody is guaranteeing that.

"It's not that (prime) is less meaningful, it just doesn't mean what it used to," says David Wolf, chief economist at Merrill Lynch Canada. "(Prime) is more likely to fall if the overnight lending rate is zero than if it's 2.5 per cent."