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Forget rate relief: Most Canadians with mortgages are about to see their interest payments soar

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Houses on a hillside in Burnaby, B.C., on April 17, 2021.DARRYL DYCK/THE CANADIAN PRESS

In Canada's mortgage market, sentiment can shift on a dime.

That's especially evident these days, as the Bank of Canada prepares to start cutting interest rates. As a result, the mortgage-rate discussion is dominated by anticipated rate relief, which could come as early as this summer. It seems like just last year, the discussion was dominated by talk of "renewal shock" – when a great many Canadian mortgage holders will need to renew their terms, at a much higher rate than what they currently have.

But this shock still lies ahead, and while rate cuts may ease the blow, a higher rate reality awaits most of today's current fixed-rate mortgage holders.

This comes down to timing. While mortgage rates are expected to start lowering within the next few months, the vast majority of existing mortgage borrowers – roughly 70 per cent – have fixed rates that remain at the record low prices available during the pandemic. (For example, the lowest discounted five-year fixed mortgage rate was 1.39 per cent, compared to 4.79 per cent today.)

Let's assume the Bank of Canada cuts rates three times by the end of this year, totalling a decrease of 0.75 percentage points. This will immediately lower rates for variable mortgage holders, as those rates are directly tied to the central bank's rate movement. Fixed mortgage rates, which lenders price based on Canadian bond yields, are also expected to lower slightly in response. However, this decrease won't be enough; even if rates fall from current levels over the coming few years, they'll still be dramatically higher than what many Canadians are paying today.

While variable mortgage rates surged in popularity during the height of the pandemic, fixed mortgage rates have always been king; of the three million mortgage loans Canadians took out in 2020, 77 per cent chose a fixed rate, according to Mortgage Professionals Canada.

Many Canadians with mortgages have already had to contend with much higher borrowing costs since the Bank of Canada increased rates 10 times between March, 2022, and July, 2023. Borrowers who've stuck it out with variable mortgages have had their payments rise roughly 70 per cent since the start of those rate hikes – they're already coping with these new world rates.

But for the majority who have a five-year fixed rate, their terms come due between 2025 and 2027 – and the impact of those renewals will be more deeply felt by borrowers and the economy as a whole.

Consider that there is approximately $2-trillion in outstanding mortgage debt. Only 5 per cent of that came up for renewal in 2023, according to Canada Mortgage and Housing Corp., with 13 per cent slated for this year. That spikes to 23 per cent in 2025, a whopping 31 per cent in 2026, and 21 per cent in 2027.

According to a December, 2023, note from the central bank, monthly payments for fixed-rate borrowers with a term of five years or longer will increase by 25 per cent by 2027 to a median of $1,444, up from $1,152 as of February, 2022, (immediately before the start of the recent rate hike cycle).

However, the CMHC says that much of the rate pain will be concentrated this year and next, with 2.2 million mortgages – 45 per cent of all outstanding mortgages – poised for "interest rate shock."

"Most of these borrowers contracted their fixed-rate mortgages at record-low interest rates and, most likely, at or near the peak of housing prices around 2020-2021. This holds true for both households who took out a mortgage when buying their new home. It also applies to the numerous existing homeowners that used the increased equity on their property by refinancing and taking cash out for consumption," Tania Bourassa-Ochoa, CMHC's senior specialist of housing research, said in note from November, 2023, adding that the total amount of renewing mortgage loans over this period represents $675-billion – or nearly 40 per cent of the Canadian economy.

While Canadian borrowers have a proven track record of making their mortgage payments, even under duress, the CMHC points out that cracks are starting to show. Despite mortgage arrears stabilizing around 0.15 per cent, defaulting payments are on the rise for other products such as auto loans, credit cards and lines of credit.

And the mortgage industry is bracing for increased fallout, which is likely to materialize as an increase in home downsizing, mortgage refinancing or outright defaulted payments.

Don't let the headlines fool you. The bottom line is that even if the Bank of Canada cuts rates, the majority of Canadians will be paying a higher mortgage rate then they are today, when their mortgage renewal comes up over the next few years.