



## Bank Of Montreal Wants Your Mortgage

### Description

As Canada's real estate market continues to chug along, perhaps the biggest profit driver for banks has been issuing mortgages. If a customer buys a home with less than 20% of the home's value as a down payment, the lender will require the buyer to get an insurance policy that pays the lender upon default. And the lender insists the buyer pays for it, albeit as a portion of the monthly payment. How many other businesses get to enjoy that kind of downside protection?

As I outlined in my earlier piece [questioning the health of Canada's real estate market](#), one of the reasons why the market has been able to make new highs is because low interest rates have made carrying costs affordable for Canadian homeowners. If the price of a home goes up and the costs to carry the mortgage remain the same, most Canadians will just worry about the carrying costs. And since most Canadians have the majority of their net worth tied up in their house, they like it when prices go up.

These facts aren't lost on the people who run **Bank of Montreal's** ([TSX: BMO](#))([NYSE: BMO](#)) mortgage department, as the company slashed the rate on its five-year fixed mortgage from 3.49% to 2.99%. This price cut made headlines around the country on Thursday morning, even prompting new Minister of Finance Joe Oliver to remark he was "watching the situation closely."

Once you delve a little deeper into the numbers, it becomes obvious that this new ultra low rate is no different than a grocery store selling cans of soup at cost to lure shoppers into the store.

Five-year mortgages are funded in two ways. The first is the bank lends out money on deposit, usually five-year GICs. This makes up just a small percentage of funding for lenders, since Canada doesn't have a large savings rate. The second, and most prevalent, is borrowing that money from the bond market. The bank's profit is the spread between the cost of borrowing (plus expenses) and the rate charged.

When the bank first dropped the rate of its five-year mortgage below 3% in March, 2013, it could borrow money for five years at 1.3%. Now that the cost of borrowing has risen to 1.7%, this will inevitably eat into the bank's margins, and in a significant way.

Notice the timing of the move as well. We're heading into spring, which is the hottest time of year for the real estate market. Bank of Montreal knows this story will be shown on financial media everywhere, giving it a nice boost of free advertising. It's a pretty effective way to get brand awareness among real estate buyers.

It also brings up an interesting double standard between Canada's big banks and secondary lenders who primarily work with mortgage brokers. **First National Financial** ([TSX: FN](#)) is one of those secondary lenders, and up until yesterday its 3.19% five-year mortgage was among the cheapest in Canada. Call me a skeptic, but I think if First National lowered its five-year fixed mortgage to 2.99% the company would barely get a mention in the media. And yet, First National is the sixth largest lender in Canada, just one spot below Bank of Montreal.

This move also puts pressure on **Bank of Nova Scotia's** ([TSX: BNS](#))([NYSE: BNS](#)) mortgage department, since nearly one in every five loans made by Canadian mortgage brokers are funded by the bank. Mortgage brokers have rewarded it with enough business to make it the second biggest lender in the country. Now brokers will start to put pressure on the bank to match Bank of Montreal's aggressive rate. I have doubts Bank of Nova Scotia will be willing.

### Foolish bottom line

The Bank of Montreal's new five-year mortgage rate is good news for buyers looking to buy property in the next few weeks. It's also bad news for lenders like First National, which will probably end up matching the rate to give its mortgage broker partners the ability to counter. But don't count on these ultra-low mortgage rates being here to stay. This is a promotion, plain and simple.

### CATEGORY

1. Investing

### TICKERS GLOBAL

1. NYSE:BMO (Bank of Montreal)
2. NYSE:BNS (The Bank of Nova Scotia)
3. TSX:BMO (Bank Of Montreal)
4. TSX:BNS (Bank Of Nova Scotia)
5. TSX:FN (First National Financial Corporation)

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