Interest Rates Are Rising in Canada Should You Be Concerned?

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Interest Rates Are Rising in Canada – Should You Be Concerned?

Interest rates have been rising slowly over the past 6 months in Canada. If you have debt, should you be concerned? First of all, if the debt you have is credit card or private debt that carries a high interest rate (20% or higher), the interest rate changes will likely not affect this. For other types of debt, it depends on what it is.

There are 2 stages in looking at this.

Stage 1- My Budget

For fixed rate debt, the rate is fixed and will not be affected by a rise in the Bank of Canada rate – yet. When you go into to renew or negotiate the next term on your mortgage, you may then notice that the range of rates you are receiving is higher. How does this affect you? A higher interest rate means a higher monthly payment. There is the trade-off of possible having a lower outstanding balance on your debt since the last time the terms were negotiated. This may mean the net effect is not meaningful for you or perhaps the savings on a lower principle is offset by the higher interest component on your debt payment.

If you have variable rate debt, the increase would take effect almost instantly, meaning that your next payment will be higher. The next thing to do is to look at your budget and see if a higher mortgage or debt payment will mean a shortage of cash for other expenses. Can this shortage be covered by cash in another account or another source? If yes, the net effect will not impact you significantly but the budget will have to be shifted to allow for a larger interest component of your debt payment. If this is a problem, the impact should be noted to see how large of an increase can be tolerated before there is a cash shortage that cannot be met.

Stage 2 – The Housing Market

What if you are okay in your personal situation, but you are concerned that the housing market will go down and impact the value of your house? The first question to ask is: Why are you living in your house? The next question is: How long do you plan to live in your house? Note that even if you have no debt but have an interest in the future of housing prices, this type of analysis will be relevant to you. If you purchased your house to live in it for a long time and are not concerned about the day to day fluctuations in the price, then there are no concerns. If you purchased the house to live in it but also rent part of it, the rental market may get affected by the price of housing since renting and home ownership are competitors for people looking to live somewhere. The more expensive a home becomes, the more people will be looking to rent. Assuming that the supply of rentals is not changing, this means a higher demand for rental units and likely higher rental rates. Higher interest rates will make housing more expensive and by corollary renting will also get more expensive. If there are rent controls and prices cannot go much higher, you will have a better choice of tenants and less vacancy time as there will be more demand for your rental unit. If you purchase your house and renting the entire property and do not live in it, the same sort of analysis is applied.

Selling Your House For Cash

What if you lived in your house and are hoping to sell it and use the extra cash? This question has many aspects to it. If you are selling your home and using it as a retirement fund or a pool of money to do something else – what is that something else? If you are downsizing and buying another smaller home in the same area, you will likely not have a large impact except that the smaller home would be cheaper to operate. If you are selling a house and buying a townhouse or a condominium, the pricing dynamics between a house or a condo will differ slightly depending on where the buying demand is coming from. If a certain area has a lot of renters, condominiums may have an advantage since they can be rented more easily. This would mean that condo prices would move down less than house prices, or move up higher in a recovery. If the demand for housing is coming from young families, smaller homes may be more in demand, meaning houses would go down more slowly and rise faster in a recovery. Why is this important? The difference in price between various types of housing will change according to what demographic or dynamic is relevant in a certain area. This difference in price is where the extra cash would be made available.

Another possibility is when you sell your house, where will you live next? If you are renting and don’t intend to buy another house, you can invest this cash and the housing prices will affect how much cash you will receive, but may not affect your overall intention. If you are selling a house and paying back a large debt against the house, when you sell will be more important as the cost of debt will rise with higher interest rates, while the price of the house may fall due to more people who cannot afford to keep their homes.

Living in Another Location

If you decide to sell and repurchase in another city, the difference in price will be key in determining how much extra cash this move will create. It is assumed that most people sell the more expensive city and buy into the cheaper area, but the reverse can also be true. This may happen if people need to move into a more expensive area for employment or for personal reasons.

There is also the element of selling your house and moving out of country, which has more variables like tax implications, currency valuation, and lifestyle changes that may not have to be considered within the same country.

Forced Sale

Lastly, what if the timing of the sale was not up to you? This would happen in the event of foreclosure. The purpose of this article is to be aware of the options before this happens. Should conditions change quickly, this may be something to contend with if you can’t make payments fairly suddenly, or the housing prices decline and you have a large percentage of debt in your home. This can mean that the home equity goes to zero or negative, and the lender is hoping you will keep paying the mortgage payments to avoid the lender taking a loss on their investment. This may also mean bankruptcy for you the borrower if you decide to give up the house and walk away from the obligation. This is the worst case scenario as there are other factors at play beside whether selling the house will happen or not. There will be issues with future credit, lifestyle, spending habits or where you live and work.

These 2 stages should be looked at together, with Stage 1 being more important for short term expenses, and Stage 2 being more important for long term or significant changes to your home environment.

Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what these options are. **Note: This article is intended for people who want to learn about the world of investments and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**