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## The Variable Rate Advantage

### Is a variable interest rate really better?

A York University professor examines the evidence

For years, experts have suggested that Canadians would be better off financing a mortgage with a short-term floating interest rate compared to a long-term fixed rate. But just how much would they save? And are the risks worth it?

Those are the questions York University's Dr. Moshe Milevsky<sup>1</sup> set out to answer in his study, *Mortgage Financing: Floating Your Way to Prosperity*.

After examining mortgage rate data during the period from 1950 to 2000, Milevsky concludes:

- Canadians would have saved approximately \$22,000 in interest payments on a 15-year, \$100,000 mortgage by borrowing at prime rate instead of the 5-year rate.
- Consumers would have been better off borrowing at prime rate compared to a 5-year fixed rate 88% of the time.

Of course, a lot has changed over the last 50 years. Interest rates have dipped to all-time lows and discounting has become a routine business practice. Given today's economic environment, is short-term, floating-rate financing still advisable?

Milevsky says yes, especially for seasoned homebuyers. After generating 50,000 different forward-looking scenarios using a custom-designed computer program, he found:

- The probability of success from borrowing at prime to be approximately 65% and the average savings on a \$100,000 mortgage to be approximately \$10,000.

While these savings don't match the historical average of \$22,000, they're sizable just the same. What's more, because there are no foolproof indicators to help consumers know exactly the "right" time to lock into a fixed rate, Milevsky believes you're better off not to guess and simply go with a floating rate.

"I advise that consumers refrain from speculating on the future direction of interest rates," he writes, "and instead focus on their budgeting ability to withstand fluctuating mortgage payments."

For more information about the benefits of having a variable-rate mortgage, please contact a service representative at any Envision Financial branch today!

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<sup>1</sup>Dr. Moshe Arye Milevsky, Associate Professor of Finance at the Schulich School of Business, York University, Toronto, Ontario, wrote the study *Mortgage Financing: Floating Your Way to Prosperity* on March 25, 2001.

#### Disclosure Statement

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