Mortgage Interest Rates Soaring - What This Means for Home Buyers and Current Owners

April 22, 2022 - If you have been thinking about purchasing a home, you may have noticed that interest rates have been soaring over the past couple of months. Depending upon the lender, rates have increased by almost 2 points since January. Based on today's interest rate guide on NerdWallet, an average 30-year fixed rate loan now has an interest rate of roughly 5.375%. And that's for a conventional loan; jumbo rates are higher. In January, according to FreddieMac, the average rate from 3.45%. But what does that mean in real terms?

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In simple terms, when the interest rate for a loan increases, monthly mortgage payments will increase and banks will reduce the amount of money they are willing to loan you. For instance, for a $500,000 home and with a 20% down payment ($100,000), the mortgage payment at 3.45% interest rate would have been $1,785. At today's rate of 5.375% with the same 20% down payment, the monthly mortgage payment would be $2,240. That's a 25% increase in the monthly payment.

As bad as that is for buyers, things are actually likely to get worse. The FED is signaling that it isn't done with interest rate increases, so by the end of 2022, 5.375% may look a lot better than it does today.

This pain isn't just impacting buyers though. It hits current homeowners too. When interest rates go up, a large number of buyers typically leave the market; either because they can no longer afford the type of home they wanted, they are unwilling to pay the higher rate and decide to wait for rates to come back down or because they no longer qualify for a loan that will allow them to purchase any home in their market area. Those that remain in the market may have to settle for a smaller home, a different area, and a lower price point. At first, sellers are typically reluctant to drop their asking price, but eventually that will change. And when they do drop their price, the money they are giving up comes straight out of their pockets at the time of sale.

For anyone who has been thinking about moving or using a portion of their home equity for some other reason, these options become much less attractive.

It's too early to tell how all of this will impact housing markets across the country. For anyone who has managed to refinance within the past couple of years, unless it is absolutely necessary a move has got to be an unattractive option.

Loans with interest rates of less than 3% were commonly available so there is a great incentive to stay put. At the same time, some people who purchased during that same time frame could find that their home value drops to less than what they currently owe on their homes. Some of these people will likely decide to give their homes back to the bank or go through a short sale. If a large number of owners find themselves in this position, we could be facing a situation that is similar to what we saw in the 2008 to 2010 time frame. In that case, it will become a buyers' market.
by Jim Malmberg
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