MORTGAGE INTEREST RATES

The Real Deal about Mortgage Home Loan Interest Rates

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The average person spends eight hours a day online and you could probably spend a good bit of that time just researching home loan interest rates. By the time you think you have it figured out…the market will close and everything will change tomorrow. Additionally, there is more to interest rates than just how they move in the secondary market (the secondary market is where mortgage back securities are traded). When you are shopping for a home loan rate it is important to keep in mind that there are three factors affecting your rate – the mortgage back securities market, the FOMC, and your actual loan scenario and the loan level price adjustments (LLPA) that are associated with it. With that in mind, we're going to offer a very brief tutorial on mortgage interest rates in general.

Brief History

According to Freddie Mac, mortgage interest rates peaked at 18% in 1981, and then began to fall, reaching an all-time low of 3.3% in late 2012. Then they inched back up into the middle 4% range, and dropped back more recently. It's not likely that we'll see rates in the double digits again anytime soon, but 5% or 6% seems to be where rates like to sit in stable markets.

WHAT AND WHO DETERMINES YOUR MORTGAGE INTEREST RATE?

Influence 1: The FOMC

Interest rates that banks are able to borrow at lend at today are set, in most countries, by central banks. In the United States, the Federal Reserve Bank and the Federal Reserve Board hold regular meetings to determine interest rates. They consider the country's economic status, and adjust the rates accordingly. These two entities combined are known as the Federal Open Market Committee. The interest rates that the FOMC set are just one component of a very complex interest rate market and are not the rates that you actually get to borrow at. The FOMC sets rates for other banks and not the retail market. They set the rates that banks can borrow from the fed window and themselves to sub sequentially lend to you.

Influence 2: The Secondary Market

The easiest way to understand interest rates and the secondary market is to visualize three buckets. One bucket is stock market, one bucket is cash, and the other bucket is fixed income market (the fixed income market is made up of us treasuries, mortgage bonds, etc.). Mortgage bonds fit into the fixed income bucket. As the global economy continues rise and fall money moves in and out of all of these market buckets depending on where investors feel they will get the best return. Often times when investors are scared of the stock bucket they decide to move their money into a safer bucket like cash or fixed income. This is called a flight to quality. When money moves into the fixed income or mortgage bond bucket rates go down. So, to understand why rates go down is to understand why money would leave stocks and cash. In regular markets where there is no artificial stimulus you can monitor a handful of economic indicators to determine whether or not mortgage rates will rise or fall. A general rule of thumb is that what is bad for the stock market is good for the mortgage market. Therefore when unemployment numbers come in high you will see the stock market go down and money will flow into the mortgage bucket driving rates lower. Mortgage rates have an inverse relationship to the cash flow…as money flows in rates are driven lower.

Influence 3: You (LLPAs)

The final piece in understanding how your interest rate is determined is to understand Loan Level Price Adjustments. LLPAs. The key concept behind LLPAs is that the more risky a loan is, the more it is going to cost you. Let's list out some of the common risk factors in mortgage loans.

- Credit score
- Loan to value
- Loan purpose – purchase, rate and term refinance, cash out refinance.
- Property Type – single family residence, condo, pud, 2-4 units
- Occupancy – owner occupied, second home, investment property

Each of the categories listed above are used in a grid to determine how expensive your loan will be. All interest rates start at a base price. The base price assumes you have a 740+ credit score, are purchasing a single family residence with 25% down that you plan on living in.

As you start to move away from the base price perfect scenario you must start adding LLPAs to the base price. For example, let us assume the same base price scenario but instead of you living in the house you are going to buy it as an investment property. This would trigger a 1.75% LLPA. How much is this? It equates to 1.75% of the loan amount. You don't necessarily have to pay this LLPA out of pocket if you don't want. Most people opt to absorb the additional LLPA by taking a higher rate. A rate increase of .375% will offset an LLPA of 1.75%. This is why investment property mortgage rates are typically higher than owner occupied mortgage. This same kind of logic applies to all of the categories listed above – lower credit = LLPA = higher rate.

Interest Rates And Timing The Housing Market:

Home sales are still healthy in Orange County, California and as a result of the low interest rate environment homeowners can move into larger houses and pay roughly the same as they were paying for smaller dwellings. Alternatively, they can move sideways into homes that are much the same as the ones to which they're accustomed, and pay less. However, at some point home loan interest rates will go up. When rates finally due move off their lows fewer people will enter the housing market, and those who are currently locked into low rates are going to be reluctant to upset their own personal apple cart by taking a higher interest rate.

This leads to a phenomenon known as "mortgage rate lock" and could create a lull in the real estate market. Home prices aren't going to crash but their increase in value will slow as fewer buyers are willing to enter the market.

For more information regarding interest rates please call me any time.

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