LFM&P

Your Personal Financial Advisor

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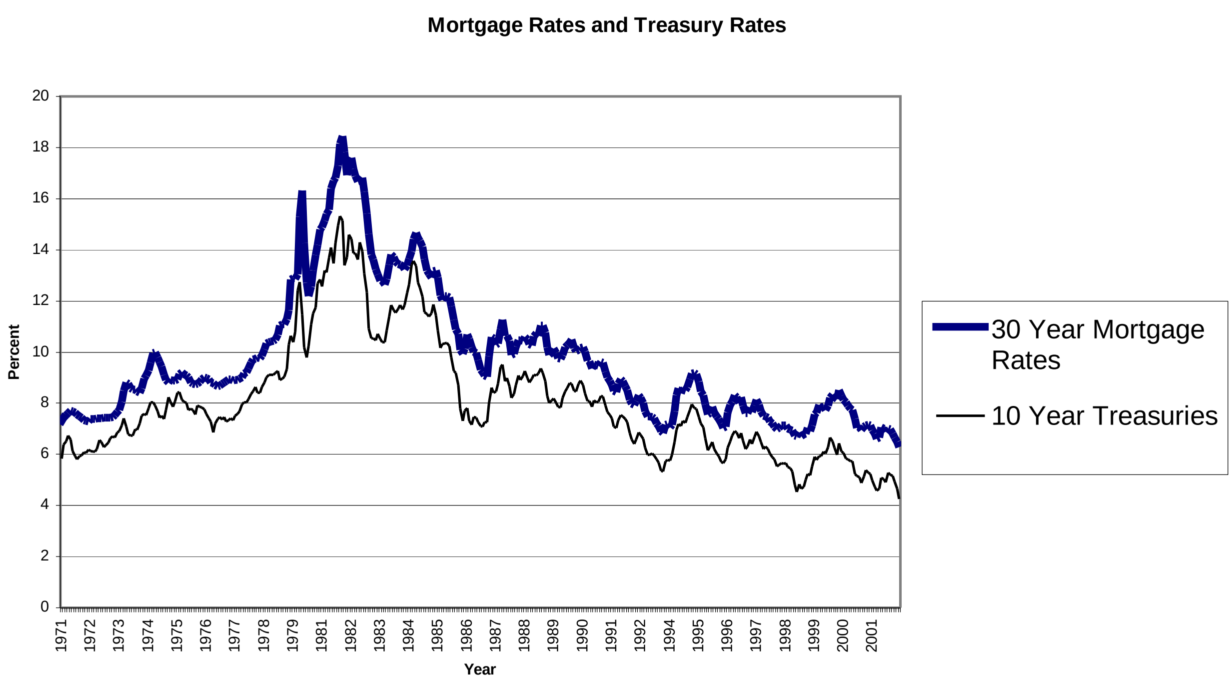
What's Happening To Mortgage Rates and House Prices?

During strong economic conditions, interest rates rise. During weak conditions interest rates fall. Residential mortgage rates follow other long-term interest rates. As you can see from the graph below, 30-year mortgage rates and 10-year U.S. Treasury bond rates rise and fall together. You can also see that interest rates have been in a long-term down trend since 1981, but there has been a rising and falling pattern that repeats itself every 4 years or so, with relatively low rates occurring in 1982, 1986, 1990, 1994, 1998 and you guessed it **…** 2002. These are the mid-term election years. These two effects have combined to produce the lowest interest rates since 1965! What will happen from here? If history is any guide, when economic growth picks up, rates are likely to rise again, at least for several years.



Source: Federal Reserve

When mortgage rates drop, people can afford bigger house loans. This allows housing to be bought for higher prices. An income that supports payments on a $200,000 loan with an 8% interest rate, can afford a $244,600 loan at 6%, an increase of over 22%. It is not surprising that house prices have increased a similar amount over the last two years. The Federal Reserve reports that repeat sales home prices have increased 24% in New England, and 16% across the country between 2000 and 2002. In addition to home values rising, lower interest rates have also provided an opportunity for homeowners to refinance their mortgages to reduce their payments or increase their borrowing.

Should I Refinance My Mortgage?

Whether refinancing a mortgage is right for you depends on a number of factors. Before you go to the bank, your should consider the value of your house, the size of your outstanding balance, your current interest rate, and whether your mortgage contains any pre-payment penalties. Other considerations include whether it is a good idea to shorten, lengthen, or keep the length of the mortgage the same, how long you plan to live in the house, and whether you intend to pay your loan off before it is due. In addition, there are wide variations in quoted rates between different lenders, so "shopping" for the best rates can be important. Lenders also offer different rates depending on the number of "points", the amount of interest you pay at the outset. Whether it makes sense to accept a lower rate and pre-pay interest "points" may depend on the term of the mortgage and how long you expect to own the house.

Additional considerations include whether you are planning to simply obtain a lower rate to reduce your payments, save money by paying back the loan earlier, or finance upcoming expenses, and how these factors fit into your over-all financial plan. Mortgage interest is generally tax-deductible, but there are limitations, especially if you are refinancing to pay other expenses.

Because of the recent steep drop in interest rates, even people who have refinanced as little as four or five months ago may be able to save thousands of dollars by refinancing again. LFM&P can help you to assess the benefits of refinancing, by either comparing your current mortgage to new mortgages being offered now, or by considering whether it makes sense for you to refinance within the context of your overall financial plan.

If you would like help analyzing a financial decision, planning how to your reach your financial goals, or investing for your future, give us a call.

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