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Home buyers: Don't forget interest

Mortgage rate increases can erase benefit of lower home prices

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By AUBREY COHEN
P-I REPORTER

Like many potential Seattle home buyers, Beth Romano wonders if she could get a better deal if she waits.

Area prices have come down a bit but are still "outrageous," Romano said outside of a Greenwood open house in late June. "I've really started to think I shouldn't buy (now)."

Romano also is like most in that she isn't factoring interest rates into when she buys.

"I think more about looking at the price, because you can always refinance," she said.

But some local real estate professionals say buyers should be mindful of rates, which probably will rise in coming weeks, potentially wiping out any savings from lower home prices along with the chance to lock in historically low rates. Others say interest rates are even harder to predict than home prices so buyers shouldn't focus too much on short-term fluctuations.

Rates still historically low

Washington interest rates, which bottomed out below 5.5 percent for a 30-year fixed-rate loan in January, are now above 6.2 percent, according to Bankrate.com. That's still low by historical standards.

"The odds of getting a better (house) price might be a little bit stronger 30, 60 days from now, but if the rate goes up a quarter of a point you might be giving that back anyway," said Cliff Taylor, production manager for Windermere Mortgage.

Erik Hand, president of Response Mortgage Services, which is real estate company John L. Scott's mortgage branch, said an easy rule of thumb is to figure that a 0.25 percent increase in the interest rate offsets a 2.5 percent price drop.

Buyers should factor in interest rate changes, Hand said. "Certainly the cost is important, but you need to look at what your monthly cost for that home is going to be as well."

Taylor and Hand predicted rates would continue to creep up.

Pam Johnson, who is moving to Seattle from the San Francisco area for work, said she has paid attention to mortgage rates.

"If I saw that interest rates were on the move upward, I'd be a little more inclined to lock into a property now, but they seem fairly stable," she said outside of an open house in Seattle's Whittier Heights.

In a market where buyers focus on their monthly payments, rising rates might force sellers to lower prices.

"Certainly higher interest rates do make it more expensive for people to purchase a home, so that might take some people out" of the market, Hand said. "It definitely impacts the pool of buyers."

But Hand, and Holden Lewis, a mortgage columnist for Bankrate.com, said tighter lending standards have had a much bigger effect than interest rate changes.

"These tighter standards result in fewer qualified home buyers, and that exacerbates the decline in house prices," Lewis said.

The exception to this is jumbo loans -- mortgages over the government-imposed cap for mortgage giants Fannie Mae and Freddie Mac. Skittish lenders pushed the gap between jumbo and conventional loan rates to more than a percentage point last summer, leading Congress to approve a temporary increase in the cap earlier this year.

"The jumbo market went into complete meltdown in August and still hasn't recovered," Lewis said. "That probably hurts prices for expensive houses. Even so, tighter loan standards probably are a stronger influence on prices."

For the Seattle area, Congress increased the cap from \$417,000 to \$567,500, although conforming loans over \$417,000 still carry slightly higher rates than smaller mortgages.

'No way to time the market'

Factoring in interest rates adds yet another complication for buyers just trying to figure out when to jump into the market. Using rates as a justification to buy now only makes sense if buyers believe that rates will climb and prices will not fall significantly.

The median price of a King County house that sold in June was \$449,700, up 2.2 percent from May but down 4.3 percent from June 2007, according to the Northwest Multiple Listing Service.

Buyers "have to balance that out in their own minds," said Glenn Crellin, director of the Washington Center for Real Estate Research at Washington State University. "Everybody has to be an economist to some extent."

Crellin's center factors interest rates, prices and incomes into its quarterly affordability index, which showed the typical King County house was 5.8 percent more affordable in the first quarter of this year than in the prior quarter and 8.3 percent more affordable than in the first quarter of 2007.

Lewis counseled potential buyers not to factor rates into their timing because rates are too volatile.

"(Rates) can switch direction in a heartbeat," he said. "When they climb rapidly, there's no way to predict whether they'll plateau in the medium term, or fall right back again."

Lewis pointed to his own weekly guesses about whether rates would be higher, lower or about the same

in five weeks.

"I've been right 29 times in the last 52 weeks," he said. "I have a .558 batting average, and I'm paid to think about this."

While the direction of home prices is more predictable, buyers should base their decisions more on life factors such as commute times, impending parenthood and the contentment or anxiety they expect from homeownership, Lewis said.

"I hear occasionally from readers who seem to regard a home purchase as primarily a financial transaction. They're the ones who are tempted to create an Excel sheet and create a graph of the predicted decline in home values versus the predicted rise in mortgage rates, and pinpoint the optimal month to buy so they get the best value over time," he said.

"They need to lighten up, live for now instead of in the future and realize that their rate-and-value predictions will be wrong anyway."

Johnson is forging ahead with her home search now, she said, even though some have advised her to wait six months.

"I feel I need to find the right property rather than find the lowest possible price," she said. "There's no possible way to time the market."

COST OF WAITING?

Windermere Real Estate provided some examples of how people might not benefit by waiting for prices to drop:

Someone who could pay about \$2,600 a month, assuming a 30-year fixed-rate loan with 20 percent down, could afford a \$562,500 house at an interest rate of 5.75 percent, \$533,062 at 6.25 percent and \$506,000 at 6.75 percent.

Interest rates on a 30-year fixed-rate loan rose from 5.75 percent on May 1 to 6.375 percent on June 16.

During that time, the average King County house sold for 98 percent of its original list price, declining from \$450,000 to \$441,000. The monthly payment would have been \$100.15 lower with the original price and the lower interest rate.

P-I reporter Aubrey Cohen can be reached at 206-448-8362 or aubreycohen@seattlepi.com. Read his Real Estate News blog at blog.seattlepi.com/realestatenews.

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