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After Record Lows, Mortgage Rates Headed Up in 2010

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Posted By: Mark Koba | Senior Editor
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Mortgage rates have inched upward in the last weeks of 2009, and that trend will continue through 2010. The question is how high they will go.

"If you told me by the end of 2010 a 30-year rate was at 6 percent, that sounds about right," says Mark Zandi, chief economist at Moody's. "I don't think there's any question rates are headed up."

Rates are still historically low heading into the new year. The average fixed rate on a 30-year mortgage was 4.94 percent the third week of December. But that's higher from the record low of 4.71 percent the week of Dec. 3.

So far, it's turned out to be a case of nowhere to go but up, says Lawrence Yun, Chief economist at National Association of Realtors.

"Rates weren't going to stay that low forever," says Yun. "But I don't see anything too alarming. Rates will still be considered attractive."

If rates seem higher, buyers and sellers need to keep them in perspective, says Jim Gillespie, president and chief executive officer of Coldwell Banker. "I started selling real estate in 1975 when rates were at 7 1/4," Gillespie says. "In the 1980's they were 17 or 19 percent. You have to go back to 1940's to see the rates we have now."

Current mortgage rate increases stem from several causes. One crucial component for keeping rates so low has been the Federal Reserve's purchases of nearly $1.5 trillion in mortgage-backed securities and giving billions of dollars in support to mortgage buyers **Freddie Mac** and **Fannie Mae .**

But all that Fed money is scheduled to evaporate in March of 2010, and the Obama home buying tax credit, which has helped spur sales, ends next April.

"The ending of the Fed program will definitely effect rates," says Mark Goldman, professor of real estate at San Diego State University. "So far, the Fed has not expressed interest in keeping the program going. That could raise rates by some 150-200 basis points."

There's also inflation. A recovering economy and a Fed concerned about rising prices could also cause mortgage rates to heat up.

"I think there's the possibility of some Fed tightening and driving up long-term mortgage rates," Zandi says. "Inflation is the key. Inflation is still low, but if it starts up, the Fed may be forced to play its hand in raising rates."

Then there are bond investors and what they can do to the mortgage market, Zandi says. "They are thinking 2011 and 2012. If they question the long-term fiscal situation and the deficit and don't buy bonds, that may also start to drive up long-term rates."

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For home buyers and sellers, the higher rates might take a toll on the struggling housing market even as some areas of the country see a slight recovery.

"Any time there are higher rates, that prices out certain buyers," says Yun. "The pool will shrink somewhat. The market's benefited from the Obama first-time buyer tax credit and the Fed purchases. If those go away, and rates rise, it might hurt certain people."

And there's refinancing. "Higher rates will slow things down when it comes to refinancing loans," says Bob Walters, vice president and chief economist at Quicken Loans. "We've seen refinancing up with the lower rates but there will be a drop off."

Whether 2010 turns into a buyers' or sellers' market depends on your point of view. For sellers seeing home values and prices decline, low rates keep buyers interested. But increasing rates pose a problem, says SDSU's Goldman.

"Affordability has been helped by falling home prices," Goldman says. "But high rates can put a damper on that if buyers sense their monthly payments are headed higher."

But higher rates could also be a motivator, says Tim Dwyer, president and CEO of Entitle Direct Group and Founder of EntitleDirect.com, a home title insurance firm. "There is a silver lining if all things are equal," Dwyer says. "The increase in rates and bottoming of house prices could result in an increase in housing activity. Once folks begin to feel interest rates rise, they are a motivator for fence-sitters to jump in and buy now rather than later at higher rates."

Even as rates head north, the jobless numbers pose a greater concern for the housing market, analysts say.

"The problem is the foreclosures," says Greg McBride, senior financial analyst for Bankrate.com. "People losing their jobs are causing most of the home foreclosures now. They (foreclosures) are undercutting home prices by 20 percent. Something needs to be done and the problem (the unemployed) is not going away any time soon."

Most experts feel it won't be higher interest rates that put the brakes on a housing recovery. **Existing home sales for November reached a near three-year increase**, and barring any kind of economic downturn in 2010, the trend should continue.

"I don't see housing damaged if rates go up," says NAR's Yun. "I think the Fed will play it by ear, and if housing needs help, I think they will extend the buying program of mortgage-backed securities. And the same is true for the housing tax credit. It could get extended as well."

Whether the government spends more to help housing or steps out of the way next spring, home buyers need to think beyond increasing rates, McBride says. "If you can't afford a house at 6 percent, than you can't afford the house. Higher interest rates won't price most people out of the market. It makes it difficult, but rates even at 6 percent are affordable."

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