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QUESTIONS ABOUT HIGHER MORTGAGE RATES

Home mortgage rates have been steep, but I understand they have leveled off. Should I wait for them to drop more before buying a home?

Earlier this summer, the national average for 30-year fixed rate mortgages was 8.34 percent, according to national mortgage tracker HSH Associates. That's well above the 6.8 percent rate late in 1998, though it's actually around the ten-year average.

Although the Federal Reserve has paused after steadily raising interest rates, there's no guarantee it won't raise them again soon. Furthermore, some housing experts point out that home prices are escalating much faster than mortgage rates in many housing markets. Thus, while your house payments might be higher because of higher rates, the equity in the home is building even faster. By waiting for rates to drop, you could lose out on significant appreciation. Of course, you still have to be able to comfortably meet the house payment, and if prices aren't rising appreciably in the market where you want to buy, that might give you pause.

Should I go with a fixed rate or an adjustable rate mortgage?

That depends on your circumstances. As rates have risen, home buyers are turning more to adjustable rate mortgages (ARMs). These rates start out below most fixed rates, but the lender can raise them after the initial teaser period ends, especially as general interest rates rise. Experts say ARMs are most attractive when they are at least two or two-and-a-half percent below 30-year fixed rates. But early this summer a one-year ARM was around seven percent, according to HSM Associates, so the spread is only a little over one percent.

ARMs can be a good choice if you think you'll be in the home no more than three or four years. But generally, many experts suggest sticking with the good-old-fashioned fixed-rate mortgage, either 30-year or 15-year. If rates rise in the future, your rate will look increasingly better. If rates drop, you can always refinance. And rates don't have to drop as much as you might think to make refinancing worthwhile. It may pay to refinance even if you only save one percent or less on the rates. This is especially true now with many lenders cutting closing costs, and in some cases offering no-cost refinancing.

What about these hybrid ARMs I've heard about?

These ARMs keep their initial rate fixed for the first three, five or even ten years before they begin to float. Their rates sometimes are not much below that of fixed rates, but if you don't plan to stay in the house more than the length of the term, it might be a good option.

What about other alternatives?

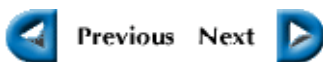
With what's called a "2-1 buydown," you start out with a loan that's below today's market rate. The rate might go up one percentage point at the end of the first year, another point the end of the second year, and another point at the end of the third year, at which point it would freeze. However, the rate at the end of the third year typically is at least half a percentage point above the fixed rate you could get today, and it would stay that way for the next 27 years.

You also can offset some of the rise in mortgage rates by making a larger down payment. However, you have to consider whether that additional down payment money might be better invested elsewhere, such as in the stock market.

You can pay more points to lower your interest rate. Each point costs you one percent of the loan, but it will lower the rate between one-eighth and one-fourth of a percent. Over the years, that can save a lot of interest.

There are many options, so before jumping at the latest TV or online ad, have your financial planner run the numbers to see what's best for you.

This column is produced by the San Diego Chapter of the Financial Planning Association. We can be a continued resource for your personal finance coverage. If you use this column in whole or part, please credit the chapter or one of our Certified Financial Planner members.



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