When the Fed Raises Its Interest Rate, Do Mortgage Rates Increase?

REAL ESTATE TODAY

By JIM SMITH, Realtor®

When the Federal Reserve raised the Fed Funds rate by a quarter percent last week, several media outlets (you know, the Fake News guys) reported that this would result in higher mortgage interest rates. However, mortgage rates fell the next day. Isn't there a connection? Not really.

Let me first say that I am not an economist, or even close to it. The last time I studied economics was as a sophomore in college, and that was only the introductory course. And since I'm not in the mortgage industry, I only know what my mortgage partners have taught me — and one thing they have taught me is that the Fed Funds rate, which is the rate banks are charged for overnight lending, has no direct impact on mortgage interest rates.

I can certainly understand why the average American home buyer and the media, untrained in business economics, might think an increase in the Fed's interest rate might apply to mortgage loans, but it doesn't.

Here's what I have learned, both from my mortgage partners over the years and, frankly, by Googling "What affects mortgage rates?" (Try that yourself if you want to delve deeper into this subject.)

Mortgage rates are influenced by such factors as inflation, the market for bonds, and consumer confidence. It is also affected by financial instability overseas which can cause money to flow into America.

Banks compete for your business (of course), so it only makes sense that what they charge for ***their*** product — money — is subject to the laws of supply and demand.

By that reasoning, if the economy is healthy and businesses are borrowing a lot of money, then banks can charge more for it, and that impacts what they charge for all kinds of borrowing, including for a home purchase.

Inflation has a direct impact on interest rates, and since any increase in the Fed Funds rate is designed to slow inflation, it actually helps to keep interest rates low, not increase them.

If the Trump administration follows through on its promised investment in infrastructure spending, that could spur the economy, which could put upward pressure on interest rates. And if there are massive tax cuts, the government may have to borrow more money to keep operating, which can also cause mortgage interest rates to rise.

Another influence on mortgage interest rates not obvious to the general public has to do with the Fed's ongoing purchase of mortgage-backed securities (MBS), in a policy known as "quantitative easing." The government holds about $1.7 trillion of these securities and only buys new ones to the extent that existing loans are paid off.

My understanding is that the Fed's purchase of such securities keeps mortgage interest rates low, and that if rising rates cause fewer homeowners to refinance — that is, to pay off their current mortgages — then there will be less purchasing by the Fed of new mortgage-backed securities, which then further feeds a rise in mortgage rates.

The "bottom line" is that the market rate for mortgages may adjust upwards in 2017, but not in step with, or related to, any increase in the Fed Funds rate.

For buyers, the more worthwhile discussion to have would be about the type of mortgage you apply for, and how you might improve the one key factor in the interest rate you pay — your credit score. I've written about this before. Read my Feb. 23, 2017, Denver Post column, which is archived at www.JimSmithColumns.com.

Too many buyers (and their mortgage brokers) gravitate to 30-year fixed loans, but those are the most expensive loans. If you can afford a larger mortgage payment each month, a 15-year fixed rate loan carries a much lower interest rate and will save you tens of thousands of dollars in interest over the life of the loan. If you ***must*** amortize your mortgage over 30 years, but don't expect to keep your home for 10 or more years, then consider an adjustable rate mortgage ("ARM"), which will be fixed at a lower rate for 5, 7 or even 10 years before adjusting upward. Your savings during that initial term can be big enough that a 5-year ARM might save you money versus the cost of a 30-year fixed rate loan, even if you keep it for 6 or 7 years.

I'm guilty of making that mistake myself. For as long as I have owned homes (that's since 1982), I've never owned a house more than seven years, yet all of my homes were financed with fixed-rate 30-year loans. I could have saved a lot by getting an ARM each time.

Learn About '8 Weeks to Wellness' Tonight

If you missed previous opportunities to learn about this holistic program which helped Rita and me lose 20-30 lbs (and keep them off), tonight's your chance. Come to **Body In Balance Wellness Center, 755 Heritage Road, Golden**, tonight, **March 23rd**, at **6:30 p.m**. Call **303-215-0390** for more information. I'll see you there!

What's a 'Closing Protection Letter,' and When Do You Need One?

The Colorado Division of Insurance reports that over the last 10 years, title companies have misappropriated $9.4 million dollars in funds related to real estate transactions. $340,000 of that was not covered by insurance, but could have been with a Closing Protection Letter ("CPL"). To better protect consumers, the Division now requires that title companies inform consumers of the availability of CPLs in their title commitments, but that disclosure is buried within the lengthy title commitment and does not explain why the client would want a CPL.

Lenders have always demanded and received CPL's to protect themselves, and that coverage protects the parties to the transaction, but some buyers and/or sellers want the added peace of mind of having their own CPLs, which range in cost from free to $25. A cash buyer definitely should request a CPL for their transaction.

At Golden Real Estate, we recently devoted one of our office meetings to the topic of title insurance and learned the importance of obtaining CPLs to protect our clients.

'Taste of Golden' Returns on Monday, Mar. 27th

This popular local event is a great excuse for out-of-towners to visit Golden this coming Monday, 5 to 7:30 p.m. Eat a light lunch that day so you can savor the offerings of several craft breweries, one winery, one distillery and a dozen or more Golden area restaurants.

Taste of GOLDEN
A showcase of Local Cuisine, Distilleries & Breweries

The event, in its fourth year, is held at the American Mountaineering Center, 710 10th Street, on the corner of Washington Avenue in the heart of downtown Golden. Golden Real Estate is a sponsor, and we'll be manning a table in the hallway outside the event.

The event is sponsored by the Golden Chamber of Commerce (I'm on the board of directors), and tickets are $30 at the door, or $25 if purchased in advance at www.GoldenChamber.org.

This event has sold out in each of the past three years, so don't count on purchasing tickets at the door. The event is open to all ages (tickets for children under 12 are $12.50), but anyone consuming alcohol will have to present a valid ID at the door.

MillerCoors is the major supporting sponsor of the event, and will be pouring its Colorado Native, made 100% from Colorado ingredients, but six Golden micro breweries will be pouring their products, too. If you come, look for me at our table!

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