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**Mark Greene** Contributor

*I write about mortgages.*



REAL ESTATE 11/08/2015 @ 7:14AM | 1,775 views

# How Much House Will A Rate Hike Cost You?

The surprisingly strong employment report that we got on Friday quickly upped the odds for a Fed Funds rate hike in December.  October delivered strong job creation, surging average hourly earnings, a decline in the unemployment rate, essentially all of the ingredients that point to real strength in the jobs market.

So at some point in the almost here future, mortgage interest rates will move higher than where they are today. Signs of real economic recovery will dominate the financial airwaves, strong jobs report data will be delivered consistently and without asterisks, inflation will ascend to target, the Fed will finally raise short term interest rates and there will be joy throughout the land.

Unless of course you are planning on buying a home and may need a mortgage to help you do that. The affect that a Fed Funds rate hike will have on monthly housing budgets and what will happen to housing market activity are now active conversation. Generally speaking, higher mortgage rates mean higher monthly mortgage payments or less buying power.

My realtor friends mostly want to know what a rate hike will mean in terms of their clients buying power, so with all of this talk about what will happen when the Fed finally pulls the trigger on the highly anticipated Fed Funds rate hike, let's look at how much house you will not be able to buy when that does happen.

Right now, a 30-year fixed rate mortgage with a 10% down payment on a $350,000 home at 4% will cost you $1,503.86/month plus taxes, homeowner's insurance and PMI (Private Mortgage Insurance). That very same 30-year fixed rate mortgage with 10% down at 4.5% will cost you $1,596.06/month. That's an extra $92.20/month and $33,191.54 over the 30-year life of your mortgage. If rates climb to 5% the incremental cost jumps to $184.40/month and $66,383.08 over 30 years.

Higher interest rates can also mean that some consumers may be forced to make a downward adjustment in their target price range. I spoke with Debbie Lansing, a realtor with Keller Williams in Montclair, NJ, and she cited real estate appraisal valuation guru Jeffrey Otteau, offering that *"each 1% increase in interest rates translates to a 9% drop in the price of the house you can afford."*

That would mean that a 10% down, $350,000 mortgage to buy a $389,000 house would downwardly adjust affordability-wise, to a $315,900 mortgage and a $351,000 purchase price.

The NAR (National Association of Realtors) publishes an Affordability Index every month measuring the relationship between median family income, median priced single family homes and prevailing interest rates. According to the NAR; *an index of 100 means that a family with the median family income has exactly the income needed to qualify for a mortgage to buy a median priced single family home*. As interest rates go up, the Affordability Index obviously goes down, however the index for 2015Q2 is pretty healthy at 159 although down from almost 177 in 2015Q1. As interest rates continue to climb, we can expect the Affordability Index to decline further and we will likely see housing market forecasts downshift as well.

When I asked Debbie what message she offers her clients, she said; "That w*hile there are many* *factors that come into play with home affordability such as local and state job market, wage increases, and of course the stock market, interest rates have a direct effect on your monthly expenditures. In our current market, there is very little inventory so prices have been pushed up by demand, but if you're waiting for more homes to come on the market and perhaps lower prices, you will likely end up paying more because of the interest rate phenomenon. That and the predictable 2-3% increase per year in home prices that a healthy market produces could mean more out of your pocket in the end. So my message is, if you see a house you love, go for it. Don't try to time the market for when more houses might be on."*

The Fed will no doubt raise short term rates at some point in the not too distant future, but as interest rates climb, people tend to come off the fence and out of the bleachers to get in the game before it gets any more expensive than it already is. Like everything else, there will be some pain while we adjust to a new norm, but the guessing is over, the countdown to launch is underway and the times they are a changin'.