

## REAL ESTATE

# Rate cut just a small step toward affording a home



A development of new homes in Eagleville, Pa., is shown on April 28, 2023. MATT ROURKE — ASSOCIATED PRESS FILE

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The Federal Reserve gave home shoppers what they hoped for last week: a big rate cut and a signal of more cuts to come.

Even so, aspiring homebuyers and homeowners eager to refinance should temper their expectations of a big drop in mortgage rates from here.

While the Fed doesn't set mortgage rates, its policy pivot does clear a path for mortgage rates to go lower. But in this case, the Fed's action was widely anticipated, so rates moved lower well before the cut was even announced.

"We've seen the bulk of the easing that we're going to get already this year," said Danielle Hale, chief economist at Realtor.com. "I wouldn't be entirely surprised if mortgage rates ticked up a bit from here before declining again."

**What's up with mortgage rates?**



When mortgage rates rise, they can add hundreds of dollars a month in costs for borrowers. The average rate on a 30-year mortgage rose from below 3% in September 2021 to a 23-year high of 7.8% last October. That coincided with the Fed jacking up its benchmark interest rate to fight inflation.

Rates have been mostly declining since July in anticipation of a Fed rate cut. The average rate on a 30-year mortgage is now 6.09%, according to mortgage buyer Freddie Mac. That's down from 7.22% in May, its peak so far this year.

Even a modest drop in mortgage rates can translate into significant savings over the long run. For a home listed at last month's median U.S. sales price of \$416,700, a buyer in Los Angeles who makes a 20% down payment at the current average mortgage rate would save about \$312 a month compared to the cost of buying the same home in May.

## So, it's time to buy?

While lower rates give home shoppers more purchasing power, a mortgage around 6% is still not low enough for many Americans struggling to afford a home. That's mostly because home prices have soared 49% over the past five years, roughly double the growth in wages. They remain near record highs, propped up by a shortage of homes in many markets.

Mortgage rates would have to drop back to near rock-bottom lows from three years ago, or home prices would have to fall sharply for many buyers to afford a home. Neither scenario is likely to happen any time soon.

Economists and mortgage industry executives expect mortgage rates to remain near their current levels, at least this year. Fannie Mae projected the rate on a 30-year mortgage will average 6.2% in the October-December quarter and decline to an average of 5.7% in the same quarter next year. It averaged 7.3% in the same period in 2023.

Mortgage rates are influenced by several factors, including how the bond market reacts to the Fed's interest rate decisions. That can move the trajectory of the 10-year Treasury yield, which lenders use as a guide to pricing home loans.

"Ultimately, the pace of mortgage and Fed rate declines will be dictated by economic data," said Rob Cook, vice president at Discover Home Loans. "If future data shows that the economy is slowing more than expected, it would increase pressure for the Fed to take more aggressive action with rate cuts which would likely translate into lower mortgage rates available to consumers."

## Buy now, or wait for lower rates?

Sales of previously occupied U.S. homes have been in a deep slump dating back to 2022, and fell 2.5% last month. So far, the pullback in mortgage rates has yet to spur a meaningful rebound, although sales did rise slightly in July.

The muted outlook for mortgage rates leaves prospective buyers and sellers with a familiar dilemma: Test the housing market now or hold out for potentially lower rates.

Nick Young, an attorney who moved his family this year from Phoenix to Evergreen, has opted to rent after seeing how competitive the homebuying market was last spring.

With a homebuying budget between \$1 million and \$1.5 million, he and his wife are still searching for that perfect gem — a house with five bedrooms to grow in with their three kids.

They're watching mortgage rates, but also other variables, including inflation, the health of the economy overall, and the presidential election.

"There's not a ton of incentive to buy currently," Young said before the Fed announcement. "But timing the market is a fool's errand."

Real estate agents from Phoenix to Tampa, Fla., say many home shoppers are waiting for mortgage rates to fall below 6%. Some are hoping rates can return to the lows of three years ago.

"What I try to do is bring them back to reality," said Mike Opyd, a broker with Re/Max Premier in Chicago. "I tell them, 'if you're serious about buying, get in now.'"

To Opyd's point, the pullback in mortgage rates and a pickup in the supply of homes on the market make for a favorable backdrop for home shoppers this fall, typically a slower time of the year for home sales.

Waiting for rates to possibly ease further next year could leave buyers facing heightened competition for the home they want. Meanwhile, potential sellers may still stay put.

"Keep in mind that 76% of people with a mortgage have a rate below 5%," said Leo Pareja, CEO of eXp Realty. "So, we may see the supply-demand imbalance actually get a little worse in the near term."

## Refinancing spree

First-time homebuyers Drew Yae and his wife bought a two-bedroom, 1.5-bath townhome in Bellingham, Wash., last month.

In February, Yae, a compensation analyst, was initially quoted a 7% mortgage rate. By the time the deal was done, his rate had come down only to about 6.63%.

"I would like to refinance at 5% or 5.25%, but I just don't know if that's realistic and if that's going to take more than two years to get there," he said.

Yae could lower his monthly payment by roughly \$300 a month if he refinances his \$407,000 home loan to 5.5%.

One rule of thumb to consider when refinancing is whether you can reduce your current rate by half to three-quarters of a percentage point.

Demand for home loan refinancing has been growing. Refinance applications recently surged 24%, according to the Mortgage Bankers Association.

Lenders are increasingly leaning into the old "date the rate" adage by pairing original loans with refinancing incentives from the jump. After buyers saw record high interest rates that peaked about a year ago around 8%, many are marketing offers that essentially give buyers a way out of their current rate once it comes back down as a way to quell buyer hesitancy.

"It is getting a lot more emphasis," said Mike Fratantoni, chief economist at the MBA. "Getting locked into a 7% rate forever — for a first-time buyer, it is terrifying."

Navy Federal Credit Union said it started offering their popular "no-refi rate drop" in 2023, which allows buyers to lower their rate for a \$250 fee while maintaining the rest of the terms on the original loan.

Many homebuyers are opting both for the temporary rate buydowns and free refinancing, said Darik Tolnay, branch manager of CrossCounty Mortgage in Lakewood.

"They all want a home, so if someone comes up with an idea to make it more affordable, given the general sentiment, people are desperate to have options," Tolnay said.

