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Rise in Rates Is Headwind for Housing

By Mark Gongloff, Nick Timiraos And Ruth Simon

U.S. 30-year mortgage rates have jumped above 5% for the first time since last spring, in a rapid rise that could present a challenge to the still-troubled housing market.

The average rate on 30-year fixed-rate mortgages climbed to 5.05% in the week ended Thursday, according to a widely watched survey by government-backed mortgage company Freddie Mac, up from 4.81% a week ago. It was the highest rate in the survey since April.

Rising mortgage rates are an immediate consequence of the large jump in the U.S. government's borrowing costs in recent weeks. Mortgage rates tend to move in line with the yield on the 10-year Treasury note, which closed Thursday at 3.712%, up from its October low of 2.381%.

The sharp rise in mortgage rates has caught some investors and economists off guard, and will likely be watched closely by the Federal Reserve, which has been buying Treasury bonds in an effort to keep rates down and bolster economic activity.

In some ways, the rate increase reflects positive news: Rates are rising in large part because there are signs the recovery is strengthening. As the economy gains steam, investors demand higher rates to compensate for an expected uptick in inflation. And if the economy can generate stronger job and wage growth, higher rates may not be a problem for housing.

But many worry that the housing market is lagging behind other parts of the economy. One risk is that higher rates could deter buying, putting further pressure on prices and squelching hope of a housing recovery for now. Many analysts expect nationwide home prices to decline 5% to 10% in the months ahead.

Still, rates remain near historically low levels, and the market has withstood much higher rates in the past. By at least one measure, housing affordability has returned to its levels before the housing boom collapsed.

Keith Hembre, chief economist at Nuveen Asset Management in Minneapolis, says rates still need to rise 0.25 to 0.5 percentage point before they become a hindrance. "But it's certainly not helpful," he said.

The run-up has been unusually swift. The national average mortgage rate has jumped to more than 5% from a record low of 4.17% in three months, according to Freddie Mac data. Freddie Mac's survey rate lags behind the market by several days; other measures are even higher. HSH Associates, a New Jersey data tracker, estimates the national average rate for a 30-year fixed mortgage at 5.17%.

Mortgage applications to purchase homes have fallen 12% in two months as rates have surged, according to an index compiled by the Mortgage Bankers Association. A general rule of thumb holds that every one-percentage-point increase in interest rates effectively raises home costs for buyers by roughly 10%.

With rates at 4.5%, a buyer typically needs income of $84,000, assuming a 10% down payment, to qualify for a $400,000 30-year fixed-rate loan. At a 5.5% rate, the income requirement rises to $92,000.

While some buyers can easily absorb the rate increase, it will squeeze others, especially first-time buyers already grappling with higher fees and bigger required down payments.

Demand has been weak in the months since home-buyer tax credits expired in May, even when rates were lower.

It is possible that news of rising rates could spur more people to buy now. There have been tentative signs of a pickup in buyer interest recently, according to a monthly survey of real-estate agents by Credit Suisse home-builder analyst Dan Op he said buyers were increasingly attracted by rock-bottom prices, nascent optimism about the economy—and a fear that mortgage rates would rise soon.

"The latest rate rise has kicked a few people off the fence; also, it's given a little bit of a wake-up call for real-estate agents to connect with clients who may have been sitting on the fence or arguing over small differences between the bid and ask" home prices, said Stephen Calk, chairman and chief executive of Chicago Bancorp, which does mortgage business in 35 states. Mr. Calk says he has seen "a little surge in the last week in purchase applications."

Others say activity has slowed dramatically. "Once mortgage rates reached the 4¾ level in December, refinance activity stopped altogether," said Lou Barnes, a mortgage banker at Premier Mortgage Group in Boulder, Colo. He says a belief that prices, while low, will fall further is keeping many would-be buyers from stepping forward.

Higher rates already have snuffed out the refinancing boomlet that took place last summer and autumn as rates sank. Mortgage applications for refinancing are down 59% from their peak in August, according to analysis by research firm Zelman & Associates.

Mortgage originations are expected to fall to lows not seen in more than a decade as higher rates dry up refinancing activity. The Mortgage Bankers Association estimates originations will total $966 billion in 2011, down from $1.5 trillion in 2010 and the lowest since 1997.

Bill Burgess, who lives in a suburb of Chicago, plans to refinance his jumbo adjustable-rate mortgage anyway. Mr. Burgess says he would have preferred to lock in a lower rate six months ago, "but if you had told me I could [get this rate] seven years ago I would have been thrilled."

Jonathan Cheng contributed to this article.

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