Monthly Mortgage Up Despite Lower Interest Rates
By Erick Eschker
April, 2006

Housing affordability has been driven to all time lows in Humboldt County. According to the Humboldt Association of Realtors, seven years ago the percent of area households that could afford the median priced home was about fifty percent. Today, it is 10 percent. That's right, 10 percent. But many people have told you that housing is more affordable than ever, since interest rates are at historic lows. They have told you that even though house prices have skyrocketed over the last five years, the lower mortgage interest rates have kept housing affordable. Don't believe them. It's true that, by itself, lower interest rates will mean a lower montly mortgage payment. But housing price increases have more than made up the difference. In February of this year (the most recent data we have) the monthly mortgage on the median priced home at the 30-year, fixed rate loan with 20% downpayment was $1,647. Just four years ago, the mortgage was $763. That's a doubling in five years.

Today, however, far fewer buyers have a 20% down payment. In 2005, many Calfornias bought with no money down. In Humboldt County, that would lead to a monthly mortgage of $2,059. I wonder how many people currently paying mortgages could afford that. Of course, the way to accurately compare dollars across time is to correct for inflation, but when we do this for mortgages, the story is the same. According the to following graph, over the five years from 1997 to 2002, the inflation adjusted monthly mortgage in Humboldt County was essentially flat at about $400 (in 1982-84 dollars). From 2002 to today, the inflation adjusted mortgage has doubled.

Why did monthly mortages double in five years despite lower interest rates? The answer comes from looking at what happened to housing prices and the quantity sold. Lower interest rates will reduce the cost of housing, which will lead to an increase in sales and a drop in the price. However, from 2002 to 2005, housing prices rose and lots more were sold. The only explanation that can account for this is an increase in the demand for housing. According to the National Association of Realtors, sales of second homes increased by 16% in 2005 and were an astonishing 40% of all home sales. Additionally, lenders reduced down payment requirements and many more borrowers used interest only and income stated loans.

There is good news for future first time home buyers, however. Since historically low interest rates did not mean lower monthly mortage payments, rising future interest rates may not mean rising monthly mortgage payments. All the "action" over the past few years has been with prices, not with interest rates. So if demand falls in the future (when everyone buying second homes realized that they are not earning a good rate of return), prices will fall, which will likely lower monthly mortgage payments regardless of rising interest rates. And there is lots of evidence that prices have begun to fall around the state. Housing inventories are rising to record levels as investors dump their properties. In Humboldt County, for sale listings have risen 20 percent in the last month. And regulators are scrutinizing exotic mortgages more and more. The effect of all of this, regardless of what happens to interest rates, will likely be lower house prices in the future, lower monthly mortgage payments, and more affordable housing. And this is a good thing for future home buyers.