MONEY

7 Tips to Get the Best Possible Interest Rate on Your Mortgage

It's not the easiest housing market. Here are ways to help your borrowing match your budget

House hunting is more enjoyable when you find a great mortgage rate.
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By Sheryl Nance-Nash

Shopping for the perfect home can be fun. Shopping for the perfect mortgage rate? Not so much.

A fast-moving housing market means borrowers need to take extra care. At the very least, you'll want to double-check your housing budget and keep a close eye on the market as rates move. Some borrowers may also want to consider new bidding and borrowing strategies to help keep the rate they pay down—if not quite to the level it might have been six months ago, when mortgage rates were still near record lows.

"It's not a time for the faint of heart to be buying a home," says Matt Hackett, operations manager at Equity Now, a direct mortgage lender.

While there's no bringing back the record-low mortgage market of 2021, here are seven tips for making the most of a difficult market:

1. Double-check your budget

Higher mortgage rates don't just mean home buyers pay more. They could mean you'll be able to borrow less. **If you set your housing budget in late 2021**, it might be time for a reset.

In one of the sharpest run-ups in memory, 30-year mortgage rates jumped from around 3.5% in January to well over 5% in May. That equates to an additional 17% surge in home prices, according to Greg McBride, chief financial analyst for Bankrate.com. (Note: Bankrate is a commercial partner of Buy Side from WSJ)

If, say, for instance, you were targeting a monthly principal-and-interest payment of $4,000 when rates were 3.5%, you could have afforded a loan in the range of $675,000. But at 5.5%, you could only afford to borrow $525.000.

If you're running the numbers at various rates using online calculators, remember you have to figure in your downpayment and closing costs, plus ongoing expenses of taxes, insurance and maintenance costs. One rule of thumb is to assume you will have to **set aside 1%** of your home's value every year to pay for upkeep.

2. Make a habit of checking rates each week

Once you know what you can spend, you'll want to make sure rates don't move on you again, putting further strain on your budget. If you're trying to make a purchase, you should check in with lenders at least once each week, according to mortgage brokers.

Weekly rate movements are typically less than 0.05%, although in this year's fast-moving market they have reached 0.25% or more, according to Mike Tassone, co-founder of Own Up, a mortgage broker.

Your mortgage broker or loan officer can keep you in the loop. You can also monitor the action yourself: You can find daily average rates in The Wall Street Journal's **markets data section**, while weekly ones are published by loan guarantors Fannie Mae and Freddie Mac.

Another tip is to follow the yield on the 10-year Treasury note (ticker symbol: TNX), which lenders use as the peg to price 30-year mortgages (since relatively few borrowers keep mortgages for the full 30-year term.) "As the yield goes up, mortgage rates tend to go up. As the yield goes down, mortgage rates tend to go down," says Cameron Cook, a senior wholesale mortgage broker with CSI Mortgage Design by Cameron in Lone Tree, Colo.

Current Mortgage Rates for August 2022

3. Consider a mortgage contingency

Once you get to the bidding stage, you want to make sure nothing can upend your deal.

One way to create a little wiggle room is to ask for a mortgage contingency in your purchase agreement. These contract clauses (which also must be agreed to by the seller) can give you an out if, say, rising rates make it no longer possible to purchase the house with 80% financing, or if mortgage rates move outside a certain range.

"This might make it easier to sleep at night," says Shaun Pappas, a partner with Starr Associates, a real estate law firm in New York.

Still, he points out there is a risk: "In a hot seller's market, many sellers will look at non-contingent deals over contingent, even if the price for the contingent deal is a little better. Sellers want firm deals with no way to cancel."

4. Tighten your rate lock

Once you pick a lender and begin the process of applying for a loan, you should be able to "lock" the rate in place, protecting you from further increases. And there are additional steps you can take to make sure there are no surprises.

Typically a mortgage lender offers a rate lock after your initial loan application has been received but before it's submitted for underwriting. Most rates are locked for between 30 to 90 days with some longer-rate lock periods offered to accommodate things like delayed closings or new construction. However, if you do not close during the rate lock period, and the rate lock expires, your rate will begin to float and be subject to daily rate changes.

One option is to extend your rate lock. It will cost you though. A typical mortgage rate lock extension costs about 0.5% of the total loan amount and can be extended for up to 120 days, says Pappas.

What if rates actually go down? You can also add a float-down provision to your loan which will allow you take advantage of any decline, as long as the new, lower rate meets a certain threshold. Usually it must be at least a quarter point below your original rate. But again, there's typically a fee associated with this as well.

While most lenders offer a rate lock as a matter of course, if yours doesn't you should definitely be proactive, according to Maura Ann Dowling, a certified financial planner and faculty member in the finance department of Bryant University in Smithfield, R.I.. "Locking in a rate is always a good idea as soon as you begin a mortgage relationship," she says. "Then, if rates move up, you are protected."

5. Think beyond the 30-year mortgage

It's not hard to see why homeowners love the security of a 30-year mortgage. But if you are looking to lower your interest rate, sacrificing a little peace of mind can lead to substantial savings.

With an adjustable rate mortgage, or ARM, the initial interest rate is fixed for a period of time. After that, the rate applied on the outstanding balance resets periodically, based on prevailing market rates. The most common introductory ARM terms are five, seven and 10 years.

Because you're are taking on future interest-rate risk as an ARM borrower, you'll receive better rates during the initial, fixed period of the loan than you would with a 30-year mortgage. In recent years ARMs haven't looked that attractive: With 30-year mortgage rates near historic lows, there wasn't much room for these loans to shave off what borrowers were paying. In recent months as rates climbed, the gap has widened.

Homebuyers who switch from a 30-year loan to a 5/1 ARM (with a fixed rate of five years) can now expect to lower their rate roughly 1 to 1.25 percentage points, based on data from Freddie Mac. That's a difference of about $300 a month on a $400,000 loan.

Of course, with a five-year floating rate loan, you could end up paying more if rates are even higher in the future. But that's only a real worry if you plan to remain in your home longer than five years. Most homeowners with 30-year mortgages **keep them for less than 10 years**.

6. Pay for mortgage points

Another way to get a lower mortgage rate is to pay your lender for it. In the mortgage world, this is known as "buying points."

Typically you can lower your rate by **one-quarter percentage point** for every 1% of the loan's total value that you pay upfront to the lender. When rates were low several months ago, relatively few borrowers chose to buy points. But, as The Wall Street Journal newsroom recently reported, the option **exploded in popularity** as mortgage rates rose.

Because of the big upfront cost, points make the most sense when you plan to stay in your house more than a few years. For instance, a borrower offered a 5.5% rate on a $400,000 mortgage could lower the rate to 5% by paying $8,000 at the outset. **The move could save the borrower** more than $45,000 if they stayed in the home for a decade, according to Bankrate.com's mortgage calculator. But they would come out behind if they moved out before year five.

In other words, if you can spare the cash, points can be a great way to save money in the long run. Just make sure you are willing to stick it out. "If you end up selling your home before you anticipate, the buy down is less attractive because the cost upfront could be more than the overall savings," says Pappas.

7. Time your mortgage decision based on your own needs

The biggest mistake you could make is to rush to make a purchase you truly can't afford because you're afraid rates could climb. "In these situations, it's better to pause your search than to get into a precarious financial situation," says Jerimiah Taylor, vice president of real estate and mortgage services at OJO Labs, a real estate company.

If you can afford the payment at current rates on the home you want to buy, it's probably foolish to hold off in the hope that 2021's rates will return, say mortgage experts.

Do your best to put forward a strong offer. In the current climate, that means making clear to the seller that the new interest-rate environment hasn't blown up your budget: "Make sure that you indicate that you have been pre-qualified for that offer," says Dottie Herman, vice chair of real estate brokerage Douglas Elliman.

If you've found a home you want and the numbers work, should you hold off for a better rate or move forward? "It's hard to bet on the market and wait for rates to decrease, because they could increase instead," says Jodi Hall, president of Nationwide Mortgage Bankers. It's OK to tune out the current collective lamenting about rising rates and buy the home you want and can afford.

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$406,250

Home price

Home price
$ 406,250

Down payment
$ 81,250

Percent Down
20 %

Loan Term
30 year fixed, 15 year fixed

Interest rate
3.010 %

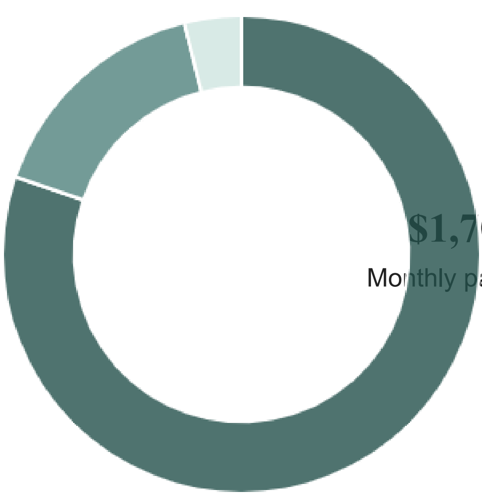
More options

$406,250
Home price

$1,709
Your estimated monthly payment

$406,250
Home price

$1,709
Your estimated monthly payment



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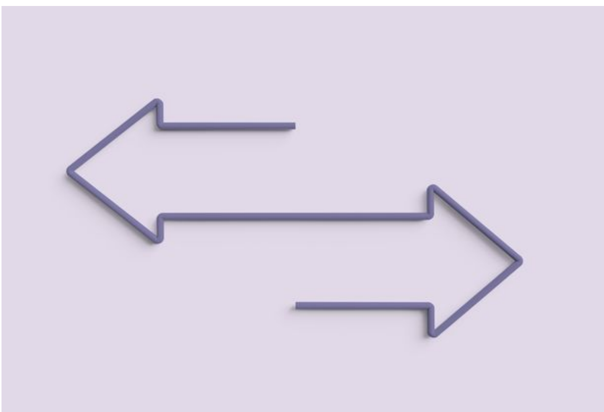

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