Mortgage interest rates would only need to head back up to where they were two years ago to start putting pressure on household budgets

Posted in Property January 25, 2017 **Greg Ninness**

Rising mortgage interest rates will mean many people are likely to have to set a bit more aside for mortgage payments this year, although it is far from certain how much and how quickly rates will rise.

But they have actually been rising for the last six months.

The average of the two year fixed rates charged by the major banks bottomed out at 4.41% in June last year, and then rose steadily to 4.58% in the end of last year, according to interest.co.nz's Home Loan Affordability Report.

And there has already been a flurry of mortgage rate increases this year, so rising interest costs are already well and truly with us.

The following table compares the average two year fixed rate in December last year with those in December 2015, 2014, 2010, 2009 and 2007.

Fortnightly Mortgage Payments at Average Mortgage Interest Rates - 2 year fixed						
Size of Mortgage	**Dec 2016 4.58%**	**Dec 2015 4.78%**	**Dec 2014 5.97%**	**Dec 2010 6.65%**	**Dec 2009 7.20%**	**Dec 2007 9.34%**
$100,000	$235	$241	$275	$295	$312	$381
$250,000	$588	$602	$687	$738	$780	$953
$500,000	$1,176	$1,203	$1,374	$1,476	$1,560	$1,906
$700,000	$1,646	$1,685	$1,923	$2,066	$2,185	$2,669

It also shows what the fortnightly mortgage payments would be under each rate for mortgages ranging in size from $100,000 to $700,000 (assuming a 30 year term).

For a $250,000 mortgage, which is probably a fairly common amount to borrow in many regional centres, the payments at the December 2016 rate of 4.58% would be $588 a fortnight.

If interest rates go back up to where they were a year earlier at 4.78%, the mortgage payments would go up to $602.

That's only an extra $14 a fortnight which shouldn't cause too many problems.

But if interest rates go up to 5.97%, where they were two years previously, the mortgage payments increase by $99 a fortnight, which could start to bite people on tight budgets.

And at the extreme end of the scale at 9.34%, which is where they were in December 2007, the payments would be an extra $365 a fortnight, which would be a frighteningly high amount of extra money for most people to have to find.

For some it would probably be impossible.

Unfortunately a $250,000 mortgage won't get you far in Auckland where the median selling price was $840,000 in December and the lower quartile price was nearly $750,000.

That makes it far more likely that someone buying in Auckland would have a mortgage of $500,000 or even $700,000.

Even for them, if interest rates rose back to 4.78% where they were in December 2015, the pain would be minimal, with payments on a $500,000 mortgage increasing by $27 a fortnight and payments on a $700,000 mortgage rising by $39 a fortnight.

But if interest rates go back to where they were two years ago at 5.97%, things start to become more difficult, with the payments on a $500,000 mortgage increasing by $198 a fortnight and the payments on a $700,000 mortgage increasing by $277 a fortnight.

Having to find an extra $100 a week or more is likely to put most household budgets under some sort of strain and that will get worse the more that interest rates rise.

Going back 10-20 years when most mortgages had a 20 year term, people who found themselves financially stressed could consider increasing the term of their mortgage to help keep payments manageable.

But the explosion in house prices that's occurred over the last few years, particularly in Auckland, has seen a shift to 30 year mortgages.

That means people who have borrowed as much as they could afford to repay while interest rates were at or near recent lows are more likely to find themselves in financial difficulties if interest rates rise significantly.

Without the option of extending the term of their mortgage to keep payments manageable they face an increased risk of defaulting on their mortgage or having to sell their property to reduce debt.

And if the rise in interest rates is accompanied by a fall in house prices, it will compound their problems and also increase the risk that the banks may not get back all of the money they loaned against the properties.

The possibility of such a scenario, however unlikely it may appear at the moment, is probably one of the reasons the Reserve Bank wants to be able to introduce debt-to-income ratio restrictions on new mortgage lending.

Such restrictions would not help those people who are already loaded up with debt, but they might reduce the size of the debt millstone that future generations take on as they climb the property ladder and the risks that go with it.