Mortgage lock-in could impact number of homes for sale

Marcie Geffner / Bankrate.com

Suppose your mortgage has a low interest rate – lower than you expect to see again. Would you stay put, no matter what, just to keep that low rate? Or would you be willing to sell your home and buy another with a new mortgage at a higher rate?

Mortgage lock-in is the state of having a home loan with such a low interest rate that the homeowner is reluctant to sell because buying another home would require getting a mortgage at a higher rate.

The question might seem highly personal. But in fact, what's known as mortgage lock-in is on a lot of people's minds because it could have important implications for home sellers and buyers, as well as owners.

Here are three things to know about mortgage lock-in:

- A rise in mortgage rates tends to be followed by a drop in home sales.
- Some homeowners stay put so they can keep their low mortgage rates.
- Most home purchases are driven by personal factors that eclipse interest rates.

What will happen as interest rates and home prices rise at the same time? Researchers at the Institute for Housing Studies at DePaul University in Chicago tackled that question for a February 2014 research brief.

The result of their simulation model wasn't favorable for housing markets.

"The growing number of locked-in households will in turn cause a deep reduction in housing turnover, or sales activity, and this reduction will be particularly steep in the strongest housing markets," the researchers wrote.

That might sound dire, but in fact, the effect of mortgage lock-in alone is likely to be small, says Sam Khater, deputy chief economist for CoreLogic, a residential property information, analytics and services company in Irvine, Calif.

Khater says that's because one-third of homeowners don't have a mortgage, so lock-in doesn't apply to them. Also, most people move in response to changes in their employment, family situation or lifestyle – not housing costs or interest rates – and mobility has declined during the past 30 to 40 years across all demographic groups for economic reasons that aren't limited to housing or interest rates.

Mortgage rates do affect housing affordability, so some buyers might downgrade their expectations. But they still will buy.

"The impact of rising rates will be bigger if it's over a shorter time horizon, but that impact is not due to a lock-in effect. It's due more to the shock of higher rates," Khater says. "Households still want to buy. They've made a decision. The higher rate simply reallocates where they move to."

Nela Richardson, chief economist for a real-estate brokerage in Seattle, says mortgage rate lock-in is "a bit of a misnomer" because it suggests homeowners are trapped in a bad situation.

Instead, she says, a low rate "is nothing but good news for homeowners" because it could allow them to keep their home as a rental property rather than sell it when they move. Or they can tap their equity to remodel rather than move.

Those options might mean fewer for-sale homes, an effect that could be more pronounced in geographic areas and at price points that already have tight supplies of for-sale homes.