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Rate Rise Clouds Recovery

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Rising interest rates threaten to dim prospects for a housing recovery and choke off a refinance wave that was a major plank of the Obama administration's economic-stimulus efforts.

On Wednesday, rates on 30-year fixed-rate mortgages climbed to 5.79%, up from 5% two weeks ago, according to HSH Associates. That jump will cut roughly in half the number of borrowers with an incentive to refinance, according to FTN Financial.

Refinance activity at J.P. Morgan Chase & Co. is already "really down" since rates began rising, a spokesman says. A rate of 4.75% "seemed to be the switch" that turned on refinance activity, he says. Now, rates are a full percentage point higher.

"Mortgage rates at these levels will hobble the [housing] recovery, and it was just the beginning of the recovery," says Kenneth Rosen, chairman of the Fisher Center for Real Estate and Urban Economics at the University of California, Berkeley.

Investors have been anxiously watching bond yields climb over the past few weeks, pushing up mortgage rates, which normally track 10-year Treasury notes. The yield on the those briefly hit 4% on Wednesday afternoon for the first time since mid-October before ending the day at 3.937%.

Many policy makers see the rise in Treasury yields as a sign that investors are optimistic that the economy is on the mend. But many market participants say higher long-term bond yields indicate investors are increasingly worried about inflation.

The Federal Reserve stepped into the market Wednesday to buy Treasurys and announced it will make another round of purchases in a week or so. But the moves seemed to have little effect on rates.

Higher mortgage rates are a blow to borrowers who were looking to refinance and reduce their monthly mortgage payments. Earlier this spring, mortgage rates had fallen below 5%, the lowest in 50 years, unleashing a wave of refinancing activity and spurring housing sales.

The rise in rates represents a setback for the Obama administration's program to help borrowers refinance their mortgages. In March, the government rolled out the Home Affordable Refinance Program, or HARP, to allow certain homeowners who owe between 80% and 105% of their home's current value to take advantage of the low rates. The administration estimated that the program could help four million to five million borrowers refinance.

Underwhelming Response

But Wall Street analysts say refinancing activity under the program was underwhelming, even before rates began to rise. Payoffs were flat last month on loans that would have seen the biggest benefit from the program, including loans originated in 2006 and 2007 with high loan-to-value ratios and high rates, according to Barclays Capital.

The HARP program is limited to loans owned or guaranteed by Fannie Mae or Freddie Mac, the housing-finance giants now controlled by the federal government. So far, some 12,710 refinancings have been completed through the program, according to the Treasury Department. Those figures don't include refinancings that have been completed by banks but not yet delivered to Fannie or Freddie. Bank of America Corp., for instance, says that it has completed 17,000 refinancings. By refinancing, borrowers on average have been able to reduce their mortgage rates by 1.3 to 1.5 percentage points, saving around $2,500 annually on a $200,000 loan, according to Freddie Mac.

The program was designed to help borrowers like Mike Gallante who weren't late on their payments but couldn't benefit from lower rates because they didn't have enough equity to refinance. Mr. Gallante, a 45-year-old who works in law enforcement, has a 6.5% rate on his $400,000 mortgage, which is owned by Fannie Mae. But his five-bedroom home in Glendale, Ariz., was appraised at $325,000, putting him above the 105% loan-to-value limit. He paid $530,000 for the home in August 2007.

"It's horrible," he says. "They have a paying customer, and they're not going to do anything to help unless I stop paying." Mr. Gallante, who says he's never missed a payment, says he's so frustrated he's considering buying a new home and walking away from his current one.

A Treasury Department official said the administration is considering a range of tweaks to the program, including extending the program to borrowers with loan-to-value ratios as high as 125%. Freddie Mac on Friday announced changes designed to make its program easier to use.

Leif Thomsen, chief executive of Mortgage Master, a mortgage banker, says higher mortgage rates are putting a damper on applications. "We have seen the daily volume go from approximately $45 million...to about $20 million," he says.

His firm typically handles about 150 loans per day. Usually, no more than about seven of those applications have been from borrowers seeking to refinance under the Obama program. "I think the intentions of the government were really good," he says. "But it just hasn't worked that well."

Jill Richardson, a mortgage broker in Atlanta, says her office has tried to put at least 30 loans through the program, but hasn't been able to refinance a single one. Among the reasons, she says, are appraisals that have come in too low, second mortgages on the properties, and extra charges levied by Fannie Mae on borrowers who have little equity, low credit scores, or who live in markets where home prices have been falling.

Slow Going

Some lenders have been slow to implement the program or have been backed-up with other refinance applications. They may be picking the best loans to do first, some analysts say.

Chriz Dally, a freelance grant writer, tried to refinance the $340,000 mortgage on her two-bedroom home in Martinez, Calif., which is backed by Freddie Mac. Ms. Dally says a loan officer at J.P. Morgan Chase, her mortgage-servicing company, agreed that her loan was backed by Freddie Mac and that she met other criteria for the program. But after making several calls, Ms. Dally says, the loan officer told her that J.P. Morgan at the time was not doing these refinances for Freddie Mac mortgages.

A J.P. Morgan spokesman says the bank refinances loans backed by both Fannie Mae and Freddie Mac that qualify under the program. There may have been "a misunderstanding by the customer, or [the customer was] talking to an employee who was confused," he says.

Richard Bernotas, a respiratory therapist in Winchester, Calif., says he has been trying to refinance his $240,000 mortgage with Bank of America for about three months. "One of the issues is that I have mortgage insurance," says Mr. Bernotas, whose current interest rate is 6.75%. Bank of America has told him he needs to wait for "phase two" of the refinance program, which will address loans such as his.

"We are not yet up and running to serve customers with mortgage insurance," a Bank of America spokesman says. "We believe we are a few weeks away."

—Serena Ng contributed to this article.

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