

## WHAT IS THE REAL PERSONAL IMPACT OF INTEREST RATES RISING?

My work is to help people (myself included) understand and apply the principles and strategies of financial independence. I was in the middle of preparing a lecture on analyzing financial statements to help make investment decisions, when I found myself wondering about the real impact of a rise in mortgage rates by 0.5%. So I invested a half an hour with my financial calculator and a few good web sites to do some analysis.

The real “aha” for me came when I realized that I was in fact doing financial statement analysis – on a personal level. This is probably a skill not common to most of the population. Yet, at the same time, the majority of the population is affected by these economic changes and could benefit from a personal analysis and by the more informed decisions they could make in response.

I was considering the impact of rising mortgage rates, so let's look at what it takes to qualify for a mortgage. First, the property must meet certain criteria then the person seeking a mortgage must qualify for a loan (unless of course they have enough money to make a cash purchase – we can still do that you know!). A lender will want at least a 5% down payment and a total debt service ratio (TDSR) of less than 40% in most cases.

What is a TDSR you ask? It's simply the total of your monthly debt obligations plus costs to maintain the property and the new mortgage payment divided by your monthly gross income. This is key information if you have any credit use. Why? Because you can have a great credit rating, but if you have too much available credit, it can impact on your ability to borrow. If you have many credit cards, even if they are paid regularly and have no balance, which can impact your ability to borrow also. These are all things to discuss with your lender – before you need a loan or mortgage.

So here's what I did: I compared a \$230,000 – 30 year mortgage at 6% and at 6.5%. If I only looked at monthly payments, the difference between the two rates was \$72.08 per month. It is important to note that this exercise can be done with any other frequency of payments with similar results. And, you can personalize the results by finding a mortgage calculator online and using your own numbers or by sitting with your own financial advisor.

So what does \$72 a month really mean? It will certainly buy some things, pay some bills or do well somewhere. I'll challenge you to seriously consider what you would do with the money. If you take this a step further, and consider the value of \$72 a month actually invested somewhere – say at 4% - over the life of your mortgage it would mean about \$50,000 to you. What could you do with an extra \$50,000? What would an extra \$50,000 mean when you're retired and your mortgage is fully paid? \$72 a month can also be used as a loan payment on about \$3,700 or at the lower rate of 6% could produce a mortgage that was \$12,000 higher. What does that do for your home? All this of course, and we haven't even considered the enormous impact of adding \$72 to your existing mortgage or loan payments – what a huge savings that could make!!

Considering that the total interest paid on a 6% mortgage of \$230,000 would create total interest over the 30-year mortgage life of \$262,502 compared to a 6.5% mortgage creating total interest charges of \$288,648 when you add a simple little \$72 a month to your 6% mortgage you end up paying only \$221,459 – a savings of 41,043!! What would you do with an extra \$72 per month – really?

There is obviously a significant amount of money at stake long term, but let's get back to today and the discussion of total debt service (TDSR). If we use the following personal financial information we can easily see that this small jump in rates really can have a profound impact today:

Gross monthly income: \$6,000  
Household heat: \$75  
Property tax: \$150  
Minimum payment on \$10,000 available credit on cards: \$300  
Car payment: \$300  
Mortgage payment on \$230,000 at 6%: \$1,368

This existing debt service would be 37%. By simply adding the extra \$72 from the higher rate we bump the ratio to 38%. This would still be within some lenders qualification requirements, but at the limit for others. Now we have a situation where we are somewhat limited in our options and more likely to experience a cash crunch.

My suggestion is to learn about some of these ratios and qualification numbers and use that information to monitor your own personal financial situation. If we treat ourselves like a business, the full economic impact of rising rates can be anticipated and planned for. Awareness of the short and long term effects that changes in the economy have on our personal lives means we are more in control and able to make more informed financial decisions – both big ones like buying a home, and day-to-day ones like whether or not to buy a \$3.50 snack five days a week - \$70 a month!

