Mortgage: Be aware of some things before Fed hikes interest rates

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Interest rates may be near historic lows, but most financial advisers agree they can't stay low forever. As the Federal Reserve weighs the timing of an increase in interest rates, smart consumers can get their financial house in order before those low rates are history.

"The general consensus is that rates will rise. Nobody expects it to be a dramatic shift, but the clock is ticking on today's low rates," said Craig Martin, director in the mortgage practice for J.D. Power and Associates, based in Westlake Village, California.

What Fed controls

The Federal Reserve can't actually "set" interest rates for financial products.

"It is more complex than it appears from the outside," Martin said.

When the Fed "raises interest rates," what it is actually doing is raising the target of 1 specific rate - the federal funds rate. This is the rate that banks charge one another for overnight loans.

Because the federal funds rate is basically the "cost" of money for banks, as the federal funds rate increases, so does the "price" of all bank-loan products.

For example, the prime rate tends to be set at 3 percentage points above the federal funds rate. The prime rate is then used as a benchmark for many short-term financial products, including credit cards and home equity lines of credit.

Check out mortgages

Financial advisers agree that if you are on the fence about buying or refinancing, now is the time to act.

"If somebody had a mortgage, that would be one of the first things I'd talk about," said Tony D'Amico, CEO of financial advisory firm The Fidato Group.

However, Martin said that just because rates are low doesn't mean you should jump into a mortgage without thinking everything through.

He said the loan product that makes the most sense depends largely on the situation of the borrower.

"If you are in your mid-20s and you think you will be stable for around five years, you might look at an adjustable-rate product that will lock in for a short time period," Martin said.

But if you plan to be somewhere for the rest of your life, a fixed-rate mortgage makes more sense.

Experts say: If you are in the market to buy a house or to refinance your mortgage, act sooner rather than later.

Rising HELOC rates

Home equity lines of credit have variable rates that are linked to the prime rate. That means HELOC rates rise when the Fed hikes the federal funds rate.

In contrast, rates on fixed-rate home equity loans don't respond directly to the Fed. They are set by the market forces of supply and demand.

Fewer lenders offer home equity loans compared with a few years ago. Instead, banks have been pushing hybrid HELOC products that let borrowers set aside a portion of the credit line for a fixed term and lock a fixed rate on it.

Refinance credit cards

Credit cards are another instrument tightly tied to the federal funds rate. So, if you are carrying a balance on a card, it might make sense to roll that balance into a low-interest card or home equity loan.

Experts say: Take advantage of historically low interest rates to refinance high-interest cards, but do this only after you fix your budget overruns.

Deposit accounts

Savings accounts, certificates of deposit and money market accounts move nearly in lock-step with the federal funds rate. As the Fed pushed down rates, your savings account was one of the first places you felt that dip; vice versa when rates rise.

Since the Fed is likely to raise rates gradually, the increases in deposit account rates will be gradual also.

D'Amico said he still strongly suggests you keep six months' worth of expenses stashed away in an emergency fund.

Experts say: Keep your emergency fund in an FDIC-insured account, but don't expect it to earn much interest, even if the Fed raises rates.

Consider car loan

Although it isn't a direct relationship, a low federal funds rate does help keep interest for auto loans low.

"Auto finance rates are influenced by the federal funds rate but do not necessarily match it," said Susan Fitzpatrick, a spokeswoman for lender Ally Financial.

Fitzpatrick said the interest rates for auto loans also depend on factors such as your credit score, the price of the car and the overall terms of the auto sale.

Rather than shopping for cars based on interest rates, Fitzpatrick recommends you take into account an accurate picture of what you can pay each month.

Experts say: Finance that auto purchase now, before rates go up, but only if buying a vehicle fits into your larger financial picture.

Also weigh factors such as down payment and maintaining a good credit score to keep your loan amount lower.

Stock, bond markets

With interest rates near 0, you may feel the temptation to borrow money to play the stock market.

Don't, said Ken Weber, president of Weber Asset Management in Lake Success, New York.

The stock market had gone up for about six years. With its recent gyrations, the market is hard to predict.

Even with historically low interest rates, it is too risky to borrow and invest with that money, Weber said.

Once rates do begin to rise, it is difficult to say what will happen to markets.

"The conventional wisdom is that both stock and bond markets will take a hit, but it is also true that stocks can climb the wall of worry, so any hit may be short-lived," Weber said.

Experts say: Invest cautiously in the stock market, but don't borrow money to invest.