

Successful Home Refinancing

4 Points To Consider

Attractive mortgage rates have spurred recent waves of home refinancing. Perhaps you joined in, or maybe you didn't but continue to wonder about a possible missed opportunity. Well, if you plan to catch the next wave and refinance your home successfully, you must have a well-conceived plan. Consider the following four points while you wait for the tide to rise once more.

1. Reduce Monthly Payments

Perhaps your catalyst for refinancing is the ability to reduce your monthly payment. However, tread carefully because, if that is your goal, you need to understand how much it costs for the privilege of paying less. That is, what fees are involved in refinancing?

For instance, if those charges come to \$1,000 and you'll reduce your monthly payment by \$25, it will take you 40 months just to break even. If you plan to move into another home in two years or so, then you're probably better off not refinancing that way. But if your monthly payment would drop by \$100, your break-even point is just 10 months, and refinancing may make more sense. Consider what is most appropriate for you and find a loan program to fit your needs.

2. Reduce Total Payments

Another consideration: What is your real objective for refinancing? If you keep your monthly payment constant but reduce your interest rate by refinancing a 30-year mortgage at an 8% rate to one at 7%, you'll pay more principal each month and pay off the mortgage sooner. For example, say you have an existing 30-year mortgage at 8% that was originally \$200,000. After the 60th month, the balance would be \$190,140. By making the same \$1,468 monthly payment but reducing your rate to 7%, you could pay off the mortgage slightly more than four-and-a-half years sooner than if you continued at the 8% rate.

Some loans may limit the amount you can prepay in a given period. If you intend to pay more than the required amount, be sure your lender allows you to do so without penalty, and that prepayments will actually reduce your principal balance.

3. Think of It as an Investment

Remember, when you refinance, your loan is now re-amortized over the new term of years. In other words, if you're five years into a mortgage and refinance for 30 years, your new payment is calculated on the amount needed to pay it down in 30 years, not 25. So carefully consider how much you'd need to pay on a monthly basis to pay off the mortgage in the remaining 25 years. It's often impossible to obtain a new mortgage for only the remaining term, but you can accomplish the same outcome by increasing your payments.

In the earlier example, refinancing the remaining balance at the lower rate would allow you to reduce your payment to \$1,265 -- a savings of \$203 per month. That seems huge, until you realize you'd be paying nearly 10 years longer than if you had instead continued to pay the \$1,468 per month. Sure, during the next 20 years you'd pay almost \$50,000 less. But, in the last 10 years, you'd pay close to \$150,000 extra. Think of it this way: Every extra dollar you pay is like getting a guaranteed return on that investment equal to the loan's interest rate. Thus, assuming you had the discipline to invest the extra money -- such as the \$203 per month in the example -- each month, you'd have to yield 7% after tax to match the return you'd get by "investing in" (paying down) your mortgage sooner.

If you wanted to pay down the new mortgage over the remaining 25 years (or 300 months) of the original mortgage, your monthly payment would drop, as a result of the low interest rate, to \$1,344. You'd save \$124 per month -- or \$37,200 over the next 25 years. More important, you'd have no mortgage balance.

4. Rev Up Payment Power

The power of making extra payments can't be stressed enough because it could potentially take years off your mortgage payments. Most mortgage companies make paying easier for you with automatic payment elections. You simply determine how much you wish to pay each month, and the company withdraws the funds automatically. This feature alleviates the monthly hassle of mailing checks -- not to mention charges and potential damage to your credit history for late payments.

Moreover, the mortgage company will grant you some flexibility in choosing when the payment drafts to your account each month. Many institutions even allow you to pay, without penalty, up to two weeks after the due date.

You can also sign up for a program that allows you to make biweekly, instead of monthly, payments -- in essence, making one extra payment each year. But by forgoing the company program and making the extra payment yourself, you can accomplish the same thing. And you can do so whether you make manual or electronic payments.

Keep Your Head Above Water

Obviously, there is more to refinancing than simply obtaining a lower rate -- or refinancing more than you need for paying off your existing mortgage. That would provide you with extra money to put in your pocket or make home improvements. We can help you determine whether refinancing is appropriate for you. We can also help you analyze the dizzying array of alternative mortgage programs available. Please call us for help.

Is an ARM Right for You?

Mortgage rate is a flexible component in your refinancing plan. In an adjustable rate mortgage (ARM), the rate is tied to an index -- though the particular index varies among lenders -- and can fluctuate monthly. Typically, an ARM is guaranteed for a specified period such as one, three, five or seven years. The loan is usually amortized over as long as 30 years based on the initial interest rate.

What's the advantage of an ARM versus a standard fixed-rate mortgage? The interest rate is typically lower -- often significantly so. In fact, an ARM is generally more attractive than a 15-year fixed mortgage rate. Also, the 15-year rate is amortized over 15 years, so the required monthly payment will be higher than a loan with the same interest rate that is amortized over 30 years.

Here's the catch: The ARM's interest rate may increase over time, particularly if you borrow when interest rates are low. But the rate could also decrease. And if it does, by continuing to pay the same amount as you previously paid, you can pay down the mortgage faster.