Refinancing 101

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As mortgages continue to be on the forefront of most economic news stories, we felt it would be appropriate to discuss refinancing in this issue.

Over the past few weeks, we've noticed an increase in calls by clients curious as to whether or not refinancing their home at this time might make sense financially. Of course, each situation is unique, so there is never one right or wrong answer. Here are a few reasons you might want to consider a refinance:

1. Lower your rate and/or monthly payment
2. Combine a first and second mortgage into one loan
3. Refinance from an adjustable rate mortgage (ARM) to a fixed rate mortgage
4. Pull equity out for home repairs, debt consolidation, etc.
5. A combination of any or all of the above!

In each of the above scenarios, there are a few things to take into account when determining if refinancing makes sense for you. Let's look at each individually:

1. **Lower your rate and/or monthly payment.** The old rule of thumb used to be 1%. That meant if you can lower your rate or payment by 1%, you can generally recoup your "cost" in a reasonable time. However, this can vary on a loan by loan basis. We usually will start considering a refinance at .5%, depending on specifics such as loan size, length of time you plan on staying in the home, and even your credit file (with really strong credit and application data, we can waive some of the "cost" items in the refinance, thus making the refinance more attractive).

2. **Combining two loans into one.** The rule of thumb with this scenario is if you can lower the rate on the first mortgage at all (even by .125%) and combine the second mortgage at the same time, the numbers will usually work. Again, some of it's based on loan size, credit file and length of time you plan on staying. The rate on the current second mortgage comes into play as well. If the rate is fixed and at a low rate, it might take lowering the first more than .125%.

3. **Changing from an adjustable (ARM) to a fixed rate loan.** This can be the "trickiest" to review to determine when this refinance might make sense. There are a lot of unknowns in the scenario. If you are on an adjustable rate, it really depends on how long the rate is going to stay at its current level. If the rate will change in less than six months to a year, it's worth considering at least looking at refinancing. In most cases, you will be increasing your rate and payment, so this is the refinance that isn't a whole lot of 'fun' when it comes to the numbers. The biggest unknown is where the rates will end up in the future. If you have three years left on your adjustable, it's really tough to predict where the rates might be at that time, so there really is no way of knowing whether you should have refinanced now vs. waiting until the adjustable starts adjusting. If you have more than one year left on your adjustable, and you would be increasing your rate by more than .5%, more than likely it will make sense to wait out the adjustable.

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Lastly, the other factor to consider is just how long you will own and live in the home once the adjustable starts to adjust. In a scenario where it adjusts, but you will be moving within a year or two, it will usually make sense to just wait and see.

4. **Pulling equity out of your home.** When considering pulling equity out of a home for home improvements, it really is less of a numbers decision and more of a personal choice. If you are able to finish a basement, create a family room, or update a kitchen, you will more than likely be improving your equity position in your home and enjoying the home you live in. If you can keep the rate close to the existing rate, more than likely a refinance to improve your home is a good decision. On the other hand, debt consolidation is very much a numbers game. If you only have a small amount to consolidate, refinancing a mortgage might or might not make sense. However, if there is a good amount of revolving debt, and you can keep your rate close to the existing rate, more than likely debt consolidation will be a good financial decision. Interest on a mortgage is tax deductible, whereas interest on revolving debt is not. Usually you can combine higher interest credit cards into a lower rate mortgage, which helps with monthly payments and for tax purposes.

5. **Combination of scenarios.** Of course, if you can accomplish a combination of the scenarios above, a refinance becomes even more attractive!

If we can help answer any questions or concerns you might have, please feel free to give us a call any time. We would be happy to talk through different refinancing scenarios, discuss some ideas, and see whether or not it might make sense for you to consider refinancing now. We feel that each client's situation is unique and will discuss all of the pros and cons of refinancing.

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