Refinancing

WHPE

Goals of Chapter

- To illustrate the hidden costs that interest adds to a mortgage payment.
- To explain how refinancing can save homeowners money.
- To explain some of the fees associated with refinancing.

Take-away messages
Over the course of a loan, you will pay much more than you originally borrowed.
Refinancing a loan can save you a lot of money on interest that you will not have to pay.

To Refinance or Not to Refinance

- The homeowner can save money
- Change the term or payout period of your mortgage
- The break-even point
- Cash-out refinance
- **The general rule is**:
  If the new loan results in at least a 1 percent, and preferably a 2 percent decrease in your interest rate, then refinancing may be worth considering.

People refinance their homes to take advantage of lower interest rates or to decrease their monthly payment. Sometimes it is done to create extra money for purchases (like a car) or for debt repayment. This type of “cash-out refinance” adds to the total debt and increases the time and cost of repaying the loan. And if your credit score is low, lenders will consider you a higher credit risk and charge you a higher interest rate.

While mortgage payments are often thought of in terms of the “principal” initial amount you’re borrowing, interest payments on the principal can dramatically increase the amount you’re paying in

Refinancing may be an important step in your retirement plan. As you think about the age you want to retire and the fact that you will likely have a fixed income at that point, you may want to look into ways to pay off your mortgage before retirement.

Before Refinancing Determine

- Possible loan fees
- Current "loan conditions" (Check your current set of loan documents and mortgage partners for refinancing approval requirements.)
- Any prepayment penalties for the new loan
- Your current credit status
- How much is left to refinance (Check your current mortgage statement.)
- Your current equity or the market value of your home.

Ask what kind and the amount of feeds to be charged on the new loan: There are standard feeds on any mortgage loan but it is important for you to look for unusual fees. Your local homeownership counselor can help you determine if the proposed loan fees are standard or not.

Consider if they have an existing second or third mortgage with restrictions: When you first bought your home, if you received some money from your lending institution and some from a nonprofit organization, the lender's loan is a first mortgage and the nonprofit's is a second mortgage. Sometimes, there are other funds available to help first-time homebuyers. A third source of funds would be a third mortgage. If multiple institutions lent money to you, you will need to meet all the conditions of their loans. Everyone (the bank, the nonprofit, etc.) has their own set of "loan conditions." For example, it is common for many families taking this course to have received "down payment assistance" which is often offered in the form of a second mortgage. Many times this is government-based funding. The city, county, state, or other government entity that made the loan may not approve of the new loan partner or mortgage holder. It is very important that you check your current set of loan documents and all of the mortgage partners to see if they approve of you refinancing their portion of your home mortgage loan.

Determine if the new loan ahs prepayment penalties: A prepayment penalty is a big red flag that indicates that the new loan that you are considering may not be in your best interest. It penalizes you if you want to save money on your mortgage by making extra payments or pay it off earlier than scheduled.

Re-examine your current credit status:

Examine your most recent mortgage statement and consider how much you have "paid down" on your loan: Most mortgages are paid out over a 30-year term. What if you live in your home and pay on your mortgage for 20 years? You would have to consider whether it makes sense to refinance the last 10- years of your mortgage loan. Remember, you pay most of the interest on your mortgage loan in the beginning. You may find that you can't save much money by refinancing.

Consider the amount of equity in the home: The price of your home was established by the "market" at the time you bought it. What if the market has changed 10 years later when you want to refinance your loan? If a "market appraisal" shows that your home has increased in value since the time you bought it, then you will want to refinance.

Refinancing to Save Money

Using an online mortgage calculator, enter:

1. The amount of your loan
2. The term (30-year note)
3. The interest rate

Calculate the payment for each interest rate.
The lower rate saves $134.21/mo.

	Current Mortgage	Refinanced Mortgage
Mortgage Amount	$100,000	$100,000
Term	30 year	30 year
Interest Rate	8%	6%
Monthly Payment	$733.76	$599.55

Refinancing to Change the Term of Your Mortgage

- Use a mortgage calculator to compare current loan to other scenarios.
- In this example, refinancing at the lower interest rate of 6 percent for a 20 year loan results in a lower monthly payment.

	Current Mortgage	Refinanced Mortgage
Mortgage Amount	$100,000	$100,000
Term	30 year	20 year
Interest Rate	8%	6%
Monthly Payment	$733.76	$672.19

- Lower interest rate and shorter time result in reducing interest paid over loan's life: **$49,996.44**

You will pay a lot less interest over the life of the loan by reducing the term of your loan from 30 to 20 years. A mortgage calculator will show that the difference in interest paid from the current mortgage to the refinanced mortgage is $49,996.44.

This may sound like an astounding number! After all, the loan was only $100,000 to begin with. But remember, that was only the principal and does not include the total amount of 8 percent interest paid over 30 years. When you signed your mortgage note, you received a document called the Truth in Lending (TIL) Statement. The TIL showed how much interest you would have to pay over the full term of your loan.

The amount of interest that we pay over 30 years surprises some people. Why? Because we often focus on the monthly payment. We sometimes forget to think about how much the "cost of borrowing the money adds to our monthly payment – the principal plus the interest. Over the term of the loan, you pay a lot of interest. The good news is that this expense is deducted from your annual federal income tax. This one reason alone is why paying interest on your home mortgage is much different from the interest paid on a car not or a credit card balance.

The Break-Even Point

- Break-Even Point: time it will take to recoup the cash you used to refinance your loan.
  (List of typical fees in chart.)
- Using the previous loan data, expenses = $5620.

Points	3	Cost of points	$2,814.76
Application fee	$500	Credit Check	$25
Attorney's fee (yours)	$25	Attorney's fee (lender)	$350
Title search	$50	Title Insurance	$930
Appraisal fee	$350	Inspections	$100
Local fees (taxes, transfers)	0	Document preparation	$250
Other	0	Total	$5,620

- Break-Even Point: Total fees ($5,620) divided by monthly savings ($61.57) results in 7 years and 6 months to earn back the cash spent on fees.

Note: Considering the interest saved by reducing the term of the loan to 20 years ($49,996.44), this a very good deal.

The break-even point
Finally, you have to consider how many months it will take to recoup the cash you used to refinance your loan. Let's assume it will cost approximately $45,620 to refinance the loan. These sample figures were input into the mortgage calculator.
With the mortgage calculator doing the math using the above figures we get:

New monthly payment	$672.19
Monthly savings	$61.57
Difference in interest	$49,996.44

You now need to calculate how long it will take to recoup the cash spent based on the money saved by refinancing. This is known as the "break-even point" or the point at which you actually begin to realize the savings you were looking for with the refinance. Let's do the math:

Cash spent to refinance ($5,620) divided by $61.57 (monthly savings) =
91.3 months or 7 years and 6 months.
You will need to pay on your mortgage for seven years and six months in order to earn back the cash used to refinance. However, when you consider the interest saved, by reducing the term of the loan to 20 years, you have made a very good deal.

Adapted from Keeping the American Dream, by NeighborWorks America.

Cash-out Refinance

- You may be able to refinance your mortgage into a lower rate, and take out some cash in equity at that time.
- This type of “cash-out refinance” adds to the total debt and increases the time and cost of repaying the loan.
- If your credit score is low, lenders will consider you a higher credit risk and charge you a higher interest rate.

Cash-out refinance
This option is not for everyone, but it could be right for you. If your current mortgage loan is at a high interest rate and you are thinking of refinancing, you may be able to refinance your mortgage into a lower rate, and take out some cash in equity at that time. If you already have a competitive mortgage interest rate, the cost to refinance is probably not worth it. But for the right family, cash-out refinancing is a nice option that both provides you with an injection of cash for improvements, and may also lower your monthly mortgage payment.