

Deciding whether to Refinance

Mortgage interest rates reached historic lows in 2010. For instance, in September the average rate on 30-year fixed-rate mortgages dropped to 4.58%. At the same time, the average rate for 15-year fixed-rate mortgages fell to 4.57%, while introductory rates for certain adjustable-rate mortgages dipped even lower.

Double-digit percentage interest rates are a distant memory. In the current interest-rate environment, many homeowners are tempted to refinance an existing mortgage, even for the second or third time. But refinancing is not as straightforward as it first seems.

Basic issues: Besides interest rates, a homeowner must factor in all the required fees before determining if he or she will actually save money. Refinancing usually involves many of the same closing costs incurred when the mortgage was initially obtained. The exact expenses can differ among lenders, but typically a borrower will have to pay for title insurance, a survey, appraisals, other administrative fees and attorney costs.

Also, consider the number of points attached to the loan. Each "point" represents one percentage point of the amount being borrowed (e.g., two points on a \$200,000 loan is \$4,000). Frequently, a low-interest mortgage carries one or more points. On the other hand, a loan offered at a slightly higher rate may be available without paying any points.

Unfortunately, a borrower currently cannot deduct the points paid on a refinanced mortgage. Instead, this cost must be amortized over the course of the loan (as opposed to an initial mortgage where points are currently deductible).

Once all the figures are available, analyze whether it pays to refinance. For instance, a key factor is the length of time a person expects to stay in the home. Estimate how long it will take to recoup the costs of refinancing.

Simplified example: John Q. Public is currently paying \$2,000 a month in mortgage interest and principal (excluding property taxes). If John refinances the mortgage, his mortgage interest and principal will be reduced to \$1,800, a monthly savings of \$200. He expects to incur \$3,000 in fees relating to the closing.

On these facts, John will recoup his costs in 15 months (\$3,000 divided by \$200 in monthly savings). From that point on, the mortgage savings are his to keep. Assuming John expects to live in the home for a few more years, refinancing generally makes sense. Conversely, if John anticipates moving in one year or less, refinancing clearly is not the best approach.

Of course, this is only a brief overview of the analysis. Other factors, such as the impact of mortgage interest deductions, can play a significant role.

In summary: The decision to refinance or not must be based on a homeowner's particular circumstances. Obtain professional assistance before making a commitment.