



Refinancing Your Home

Should you refinance your home mortgage? That's a question many homeowners are asking, given the lower mortgage rates that are currently available.

But, how do you decide if refinancing makes sense in your particular case? The answer depends on many factors, including your tax bracket, the length of time you plan to stay in your home, and the additional costs and charges you must pay for the refinancing.

What follows is information to help you decide whether to refinance your home mortgage and how to go about doing it.

How much will it cost to refinance your mortgage?

When you refinance your mortgage, you usually pay off your original mortgage and sign a new loan. With a new loan, you again pay most of the same costs you paid to get your original mortgage. These can include settlement costs, discount points, and other fees. You also may be charged a penalty for paying off your original loan early, although some states prohibit this.

The total expense for refinancing a mortgage depends on the interest rate, number of points, and other costs required to obtain a loan. To obtain the lowest rate offered by the lender, most lenders will charge several points, and the total cost can run between three and six percent of the total amount you borrow. So, for example, on a \$100,000 mortgage, the lender might charge you between \$3,000 and \$6,000. However, some lenders may offer zero points at a higher interest rate, which may significantly reduce your initial costs, although your payments may be somewhat higher.

Is the interest rate low enough to save you money?

Talk to some lenders to determine the available rates and the costs associated with refinancing. These costs include appraisals, attorney's fees, and points. Then determine what your new payment would be if you refinanced. You can estimate how long it will take to recover the costs of refinancing by dividing your closing costs by the difference between your new and old payments (your monthly savings). However, the ultimate amount you may save depends on many factors, including your total refinancing costs, whether you sell your home in the near future, and the effects of refinancing on your taxes.

The old rule of thumb used to be that you shouldn't refinance unless the new interest rate is at least two percentage points lower. However, many lenders are now offering zero

point loans and low-cost refinancing. Therefore, even if your rate change is less than one percentage point, you may be able to save some money by refinancing.

How many "points" must you pay to the lender to obtain the loan?

In refinancing, lenders usually offer a range of interest rates at different amounts of points. A point equals one percent of the loan amount. For example, three points on a \$100,000 mortgage loan would add \$3,000 to the refinancing charges.

Shopping for points as well as interest rates may save you money. As a rule of thumb, each point adds about one-eighth to one-quarter of one percent to the interest rate the lender is offering.

Generally, the lower the interest rate on the loan, the more points the lending institution will charge. Some lenders offer refinancing with no points, but generally charge higher interest rates.

To decide what combination of rate and points is best for you, balance the amount you can pay up front with the amount you can pay monthly. The less time that you keep the loan, the more expensive points become. If you plan to stay in your house for a long time, then it may be worthwhile to pay additional points to obtain a lower interest rate.

Some lenders may offer to finance the points so that you do not have to pay them up front. This means that the points will be added to your loan balance, and you will pay a finance charge on them. Although this may enable you to get the financing, it also will increase the amount of your monthly payments.

What other settlement costs will the lender require you to pay at closing?

Settlement costs typically include fees for the loan application, title search, appraisal, loan origination, credit check, and lawyer's services. You also may be required to pay recordation fees or transfer taxes. If you are shopping for a lender, ask each one for a list of charges and costs you must pay at closing. Some lenders may require that some of these costs be paid at the time of application.

How would refinancing affect the taxes you owe?

With a lower interest rate on your home loan, you will have less interest to deduct on your income tax return. That, of course, may increase your tax payments and decrease the total savings you might obtain from a new, lower-interest mortgage.

You should be aware of an Internal Revenue Service (IRS) ruling with respect to points paid solely for refinancing your home mortgage. IRS regulations require that interest (points) paid up front for refinancing must be deducted over the life of the loan -- not in the year you refinance -- unless the loan is for home improvements. This means that if you paid a certain number of points, you would have to spread the tax deduction for those

points over the life of the loan. If, however, the refinancing is for home improvements -- or a portion of the loan is for this purpose -- you may be able to deduct the points -- or a portion of the points -- under certain circumstances. Check with the IRS regarding the current rulings on refinancing, particularly if you are using the new loan to make home improvements.

Should you also consider a different type of mortgage?

If you are thinking about refinancing your mortgage, you might want to consider other types of mortgages. For example, you might want to look into a 15-year, fixed-rate mortgage. In this plan, your mortgage payments are somewhat higher than a longer-term loan, but you pay substantially less interest over the life of the loan and build equity more quickly. (Of course, this also means you have less interest to deduct on your income tax return.)

You also might want to consider refinancing if you have an adjustable rate mortgage with high or no limits on interest rate increases. You might want to switch to a fixed-rate mortgage or to an adjustable rate mortgage that limits changes in the rate at each adjustment date as well as over the life of the loan.

If you decide to apply for refinancing with a particular lender, and if you do not want to let the interest rate "float" until closing, get a written statement guaranteeing the interest rate and the number of discount points that you will pay at closing. This binding commitment or "lock-in" ensures that the lender will not raise these costs even if rates increase before you settle on the new loan. You also may consider requesting an agreement where the interest rate can decrease but not increase before closing. If you cannot get the lender to put this information in writing, you may wish to choose one who will.

Most lenders place a limit on the length of time (say, 60 days) they will guarantee the interest rate. You must sign the loan during that time or lose the benefit of that particular rate. Because many people are refinancing their mortgages, there may be a delay in processing the papers. Therefore, you may want to contact your loan officer periodically to check on the progress of your loan approval and to see if additional information is needed.

What do you look for when shopping for a home mortgage?

If you decide to refinance your mortgage, shopping around by calling several lending institutions to ask each one what interest and fees they charge will help you get the best deal available. Also ask each about their "annual percentage rate" (APR) and compare them. The APR will tell you the total credit costs of the refinancing, including interest, points, and other charges.

Remember, you do not have to refinance your mortgage with the same lender that provided your original mortgage. However, to keep your business, some lenders will

offer their original mortgage customers the incentive of lower mortgage interest rates, sometimes with reduced closing costs.

What disclosure must the lender give you?

For a refinancing, the lender must give you a written statement of the costs and terms of the financing before you become legally obligated for the loan, as required by the Truth in Lending Act. You usually will receive the information around the time of settlement, although some lenders provide it earlier. You will want to review this statement carefully before you sign the loan. The disclosure tells you the APR, finance charge, amount financed, payment schedule, and other important credit terms. If you refinance with a different lender, or if you borrow beyond your unpaid balance with your current lender, you also must be given the right to rescind the loan. In these loans, you have the right to rescind or cancel the transaction within three business days following settlement, receipt of your Truth in Lending disclosures, or receipt of your cancellation notice, whichever occurs last.

Will the lender refund your application fees if you do not sign the mortgage?

When you apply for a mortgage, some lenders require you to pay a special charge to cover the costs of processing your application. The amount of this fee varies, but it may be \$100 to \$200. Usually, you must pay this charge at the time you file the application.

Some lenders do not refund this application fee if you are not approved for the loan or if you decide not to take it. So, before you apply for a mortgage, ask lenders whether they charge an application fee. If they do, find out how much it is and under what circumstances and to what extent it is refundable. However, if you elect to cancel the transaction within three business days after you close the loan, as discussed above, you are entitled to a refund of all costs and charges imposed for the credit transaction.

Use Conventional Means to Buy a Conventional House

If your credit history is tarnished or your income is low, you may qualify for a FHA or VA mortgage. Conventional loans require that mortgage payments, property taxes and home owner's insurance combined not be more than 28% of gross income and those payments, plus any other debt, not be more than 36% of your gross income – known as the 28/36 ratio. The less conventional FHA ratio is 29/42. The VA is more lenient at 41/41.

If you don't have enough money for a down payment on a house, Freddie Mac, a government-sponsored company, has special programs for low-and middle-income buyers with very little cash. Check with your local bank or mortgage broker. Fannie Mae has similar loans: 800-732-6643 or visit: www.homepath.com.