

The WHY, HOW and WHEN to REFINANCE

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Are you concerned about your high interest rate loan? Are you facing the potential of a large interest rate increase, or dreading a looming balloon payment? If so, it may be time to refinance.

As interest rates decline, many homeowners will consider refinancing their real estate. Due to a lower interest rate, refinancing may not only generate immediate savings, but it may also allow restructuring of debts and provide funding for other purposes. .

Why Refinance?

Simply stated, to save or obtain money. The lower the interest rate, the less it will cost for the money borrowed. ***As a rule, if the cost to refinance can be recovered in less than the time you anticipate owning the property, it is time to refinance.***

A Lender may rightfully suggest to you that as current interest rates are dropping, and in some instances as little as three quarter of a percentage point below your present mortgage rate, it is time to refinance. This factor should be considered, but should not alone control your decision. ***Rather, before refinancing, be certain that the cost to refinance can be economically recovered over the remaining term of the loan; that being, not the number of years left on your current mortgage loan, but rather the number of years you intend to continue to own the property to be refinanced.***

Consider the following example:

Joe and Jane Smith purchased their home in 2004 for \$200,000.00, securing a mortgage of \$160,000.00 at a fixed interest rate of 7% to be repaid over the next 30 years. The Smiths' home is now valued at \$250,000.00 and they plan to move and build a new home in 3 years. Should they refinance their \$160,000.00 loan at the present rate of 5.5%?

Various factors must be considered. And even though the monthly savings may be impressive, the Smiths' will incur considerable refinancing cost.

Estimated costs to refinance the Smith's \$160,000.00 mortgage:

Bank Charges called Points*	\$ 0.00 to \$4,800.00
Appraisal & Credit Report	375.00
Other Bank Fees	750.00
Title Insurance/Endorsements/and other charges**	1,407.88
Notary Fee	25.00
Recording new Mortgage	125.00
Satisfying Old Mortgage	40.50
TOTAL:	\$2,723.38 to \$7,523.38

*These charges may be called "commitment", "origination", "discount" charges, but they are generally referred to as points, with one point being equal to one percent of the new mortgage loan.

** This charge may vary substantially, and as such a prudent Borrower will shop around, not simply select the Lender's recommended Title Agency – Note: A lender may only designate a title company if they have no interest in that Company. The estimated other charges include or reflect a reissue rate, title endorsements for a fixed rate loan on a single family home and closing protection letter

In the current market, many Lenders' commonly charge between 0% to 3% points, a point being one percent of the new loan, plus application, document preparation and other fees of generally hundreds of dollars to refinance loans. Lenders also in most instances require the borrower to obtain title insurance and arranging closing services to refinance, the cost for which will vary depending on the title insurance company selected.

To justify refinancing, the cost to refinance must be recovered over the life of the new loan. In other words, since the Smiths plan to sell their home in 3 years, only 36 months remain for them to recover these costs. By dividing the closing cost that the Lender must estimate at time of application, by the number of months that the Smiths will remain in their home, the resulting "threshold amount", which in the example is \$75.65 ($\$2723.38/36$) is then simply deducted from the old monthly mortgage principal and interest payment to determine if the refinancing is justified. ***(Please note, do not add in escrow deposits paid to the Lender for insurance and taxes in this calculation, as they should generally be unaffected by the transaction.)*** In the example, the resulting amount ($\$1,064.48 - \75.76), of \$908.72 is more than the Smiths' new mortgage payment (principal and interest only), of \$908.46, and therefore it is time for the Smiths' to "consider" refinancing.

In our example, the monthly cost of the old mortgage is \$1,064.48 (principal and interest only); whereas, the new monthly mortgage cost will be \$908.46. Therefore by refinancing, if the Smiths' remain in the property for three-years as planned, they will reduce their payments by \$156.02 per month or \$5,616.72 (36 @ \$156.02).

There are however other factors that must not be overlooked.

The Smiths' upon refinancing the 2004 mortgage loan of \$160,000.00 will be both paying the cost for the new loan and also satisfying the old loan. If the remaining balance of the old loan in 2008 is from the example \$152,586.10, the Smiths' will have \$7,413.90 remaining after satisfying the old mortgage to pay the cost. The remaining balance, or cash out at closing, of \$4,690.52 (\$7,413.90 - \$2,723.38) may therefore cause the Smiths' to consider paying 1 to 3 points for the new loan and thereby lower the interest rate for the new loan.

The Smiths could also decrease the new loan to the sum actually needed to satisfy and close the loan, that is borrowing \$152,536.10 plus closing cost of slightly less than \$2,723.28, in which scenario the new mortgage payment would be in the example \$881.55 per month, as a result of which the "true savings" over the remaining three-years they will live in the home is even greater.

Home purchased in 2004	
Purchase price	\$200,000.00
Mortgage	\$160,000.00
Current home value	\$250,000.00
Current mortgage balance	\$152,586.10

Although the example describes how the estimated savings by refinancing may be determined, the Smiths may have other reasons to refinance. As a further example, should they need the down money for a new home, they may consider refinancing 80% of the current value of their home, or \$200,000.00 as opposed to \$160,000.00, as a result of which they will have immediate use of an additional \$40,000.00 for this or other purposes. In the example, the new monthly mortgage payment will increase by only \$71.10 (to \$1,135.58) per month, but the increased payment amount is mostly interest, and the interest may be fully tax deductible.

Furthermore, the additional funds may be used to pay off other debts, such as car loans or credit cards, which loans may be at a higher interest rate, and on which the interest is not generally tax deductible. The additional funds may even be invested in investment vehicles the Smiths believe will return to them a sum greater than the 5.5% per annum they are paying for the loan.

As with the stock exchange, the commodities market and most other forms of investment however, real estate values are affected by interest rates and the economic condition of the country. Many homeowners will refinance now if they foresee a rise in

interest rates at a later date, others may wait and gamble on a further fall in rates. The decision of when to refinance is therefore up to you.

Therefore, whether refinancing is desired to lower the rate or to get cash out of your home, the loan process is to a great extent fairly similar for all Lenders, but the rates may vary. As such first determine the costs, which all Lenders must estimate for you. ***Consider not only the interest rate, but also the points to be paid and the rate offered, and all other charges associated with the loan and the funds necessary to pay off your present loan. Ask your Lender to compare rates for the various loan products they offer, e.g. a zero point or 5/25 loans.***

Keep in mind that even though the process is very similar, there are many different loan products. And lastly consider the reliability, service record and reputation of the Lender with whom you are dealing, for that alone may be your greatest concern. Be sure to select a loan and Lender that offer you a product that you find best suits your financial situation and will best service your future needs.

Once you have selected a loan product and Lender, it's time to order title insurance. The premium for title insurance is your expense, so as with the loan, seek the best service and lowest cost. ***Regardless of what you are told or may believe, title insurance rates and services are not all the same. In most cases, the selection of a title company and agency is yours - so choose wisely.***

When to Refinance:

When all factors set forth herein have been considered and tell you: **"I will save by refinancing"** or **"By refinancing, I can use the equity out of my home for other worthwhile purposes"**-- it is time to refinance.

Looking to Refinance?

CALL US FIRST! 610-277-6300 for ALL YOUR TITLE INSURANCE NEEDS!

John D. Maida, Esq. is a Pennsylvania attorney with over 30 years of real estate and title experience. Author of a Practical Guide to Buy and Sell Real Estate and Save, he has also published many newsletters and articles on real estate and orchestrated seminars for various professional groups.