

Refinancing Can Be A Good Idea

Last month I wrote about some of the potential benefits of owning a home and encouraged those who were on the fence about it to give it another look. Real estate is more affordable today by historical standards than it often is and, when you couple the potentially attractive purchase prices with nearly unprecedented interest rates, it certainly makes owning real estate something to consider.

But what about those of us that already own a home? Is there any way for us to benefit from today's environment?

In many cases the answer is yes.

I would strongly encourage everyone that owns a home to take the time to review your current mortgage sometime in the near future. If it has been awhile since you bought the home and/or you haven't refinanced within the last few months, you may be able to substantially lower your interest rate – which can translate to lower monthly payments or an accelerated pay off schedule. Any time you are paying less interest on the amount you owe it is almost certainly a good thing.

Let me give you a real world example.

I recently met with a client that last refinanced about four years ago. She currently owes \$385,000 and has 26 years remaining on her mortgage with a fixed rate of 5.625%. Her monthly payment is \$2380.

We looked at a couple of options if she were to refinance today. As of the day I am writing this, the 30 year fixed rate available at one of the banks in town is 3.875%. If my client were to refinance and go with another 30 year loan she could lower her monthly payment to \$1810 – a reduction of \$570 per month.

For this particular client, the affordability of the monthly payment is not the primary reason for considering refinancing. She would rather not extend her mortgage by 4 years (going from the current 26 years she has left on her current mortgage to a new 30 year schedule).

We looked at what would happen if she refinanced to a 15 year fixed mortgage instead. Again, as of the day I am writing this, the 15 year fixed rate available at one of the local banks is 3.15%. If my client were to refinance to a 15 year fixed rate mortgage at that rate her payment would only increase by about \$300 a month to \$2682.

She was thrilled and amazed that for just another \$300 a month she was going to be able to have her home completely paid for a full 11 years earlier than she had expected. And, if she would decide to sell the home before then, she would be building equity faster as a greater portion of her monthly payments would be applying to principal. It really is a win, win situation for her.

Keep in mind that there are costs associated with refinancing a mortgage and those costs should be disclosed by the mortgage representative up front and factored into your decision process. The cost to refinance can vary but often falls between \$1500 and \$2500 in this area (not including points, if any). Often that cost can be added to the mortgage but you may prefer to pay it directly.

I am often asked about how much of a reduction in interest rates it would take to make refinancing a sound financial decision. Unfortunately there is no blanket answer to that question as it really does depend on the specifics of the situation. The larger the mortgage the more benefit in terms of dollars saved there is for each incremental decrease in interest rates but other factors certainly do apply. Some other things to consider include the costs of refinancing and how long you intend to own the home.

An issue that has unfortunately arisen for many people is that their home has declined in value since the time they took out their mortgage. In some cases that can mean that there is less than 20% equity available - which can mean having to either pay down some of the principal to get to 20% or paying private mortgage insurance (PMI), which adds an extra cost to the mortgage payment each month. This possibility, and the potential options for addressing it, should be discussed with the mortgage representative at the start of the process.

For those who may be facing an issue with the amount of equity they have – or that may even owe more on the house than it is worth – there may be programs available to help you. Next month I will discuss some of the options, both currently available and proposed.

The bottom line is that if you own a home and have a mortgage you should take the time to meet with a qualified mortgage professional to explore whether you may benefit from refinancing. You may find that the potential benefits are significant.

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