Should You Refinance Your Mortgage?

Last year, interest rates were on the rise, and I expected them to continue rising. Therefore, I refinanced the adjustable rate mortgage I had on a rental property. Apparently, I did not time that too well because rates immediately began to fall and have continued to decline. I can't believe that 10-year government bonds are back to 1.7% and the average 30-year fixed rate mortgage has fallen to 3.7% (as of 08/02/2019). This is not far from the all-time low of 3.5% set in December 2012.

Many homeowners are once again asking themselves if it makes sense to refinance.

One of my clients just refinanced and was able to reduce their interest rate from 4.5% to 3.6%, saving themselves almost $1,000 a month.

Many reasons exist to refinance a mortgage such as:

1. You want to change the term (number of years until payoff) or type (adjustable rate to fixed rate) of your loan.
2. You want to eliminate private mortgage insurance (PMI), which is charged to borrowers who made a small down payment (less than 20%). Once you have more than 20% equity, you can usually refinance and eliminate the PMI.
3. Cash out Refi: This may make sense if you want to tap your home equity to eliminate higher interest debt by rolling it into your lower interest rate mortgage.
4. Your credit has improved, enabling you to qualify for a lower interest rate or different type of loan.

Closing Costs:

It is tempting to refinance to get a lower rate and lower monthly payment any time rates decline. However, refinancing will require you to pay a new set of closing costs. The average closing cost for refinancing a mortgage in America is $4,345. These costs vary depending on the lender, amount financed, and location of the mortgaged property. Loans advertised with “no closing costs” or “no fees” often are really still capturing those fees by burying them in the amount borrowed or a slightly higher interest rate.

How long to break even?

Refinancing is only worth doing if the amount saved on monthly payments will be enough to earn back the extra closing costs by the time you pay off the mortgage or sell the property. You may not know how long you will keep the property, but you can calculate your “break-even” point. To figure out how long you need to keep the loan to make refinancing worthwhile, divide your closing costs by your monthly savings. For example, if your refinance saves you $150 a month and it costs $6,000, divide $6,000 by $150 per month to find you need to keep the new mortgage for 40 months—before you break even. The refinance was a bad idea if you sell the home before then.

Refinancing makes the most sense…

1. Refinancing makes more sense on bigger loan balances. The closing costs of the larger loan will be higher, but not proportionately higher. Homeowners with smaller mortgage balances may need to reduce their interest rates 2 percentage points for refinancing to make sense. Homeowners with larger mortgage balances could achieve enough cost savings with a less than .75% rate drop.
2. You also have the potential for bigger savings if you are refinancing earlier in your mortgage term. One thing that makes comparing mortgages difficult is different terms. For example, you may have a lower monthly payment if you refinance from a loan with 13 years left to a new loan with a 15-year term. However, the lower monthly payment is not all savings because you will be making payments for two additional years.

Calculators and Rate Shopping:

Many free mortgage calculators (such as this one) can be used to take all of these factors into consideration.

Refinancing can also require a fair amount of time to compile all the documentation and complete applications, appraisals, and inspections. However, not many other ways exist to save hundreds of dollars per month without changing your lifestyle.

If you are interested in refinancing, you can get an idea of the lowest available interest rates HERE.

Have a great weekend.

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