SmartMoney

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The Refinancing Dilemma: Should I Do It?

Did you miss the super-low-mortgage-rates boat?

Since the Federal Reserve ended its program of purchasing mortgage-backed securities at the end of March, mortgage rates have ticked up. Average 30-year fixed rates were 5.21% for the week ending April 9, up from 5.05% about a month ago, according to HSH Associates, a mortgage-data tracking firm. And if the economy keeps on current course, HSH expects to see conforming 30-year rates in the 5.75% to 6% range by end of 2010, give or take a little, says Keith Gumbinger, vice president at the firm.

Plenty of qualified homeowners have already taken advantage of the low rates and reduced their payments with a refinance. But activity has moderated some.

“Refinancing has definitely slowed down over the last month or so,” says Bruce Brown, a certified mortgage planning specialist with Pulaski Bank Home Lending in Kansas City, Mo. “It seems that every time rates would drop below 5% we’d get a rash of refinances,” he says, which slows down when they move back over 5%.

“There are still lots of people who can benefit from refinancing,” Brown says.

A handful of factors must be weighed when deciding to refinance a mortgage. Among them: the cost to refinance, the monthly payment savings, and how long you plan to be in the property. As long as you figure you can recoup your refinancing costs within 12 to 18 months, a refinance can be a sensible move, says Frank Ruzicka, a mortgage banker with Cornerstone Mortgage in St. Louis, Mo. (Read our story about costly *refinancing fees* [1].)

Here are some refinancing options to consider:

Fixed rate

Borrowers with an adjustable-rate mortgage may be concerned that they won’t be able to afford their payments once their rate resets – at a possibly higher rate. (The rates on these loans adjust on a specified schedule after an initial fixed period based on movements in an interest rate index.)

In that case, they should consider refinancing into a fixed-rate loan, says Jack Guttentag, a professor of finance emeritus at the Wharton School of the University of Pennsylvania.

The savings they’re enjoying now from the low ARM rate (which on average run a point below the 30-year fixed rate) may not justify the risk of getting caught by a rate increase later. The value comes from the predictability of having a mortgage payment that won’t reset.

Locking in a rate now is particularly a good idea for borrowers who had gotten an ARM with the intention of living in the home for, say, five years, but because of real estate conditions, have to stay longer in the hope of a rebound in home values, says Tim Galligan, sales manager and mortgage consultant with 1st Advantage Mortgage in Lombard, Ill.

ARM

Adjustable-rate mortgages “ have gotten kind of a black eye in the last few years. People assume any adjustable was a subprime loan. That’s not the case,” says Galligan.

In fact, refinancing from a fixed-rate loan into an adjustable-rate loan in order to take advantage better rates in the short term could be a good option – but only if you’re sure about how long you’re staying. If somebody has been in their home for five years and had planned to stay there for just 10 years anyway, why pay 5% on a 30-year fixed when you can pay 4% on a five-year fixed, Galligan says.

These days, Brown says, borrowers can get a seven-year ARM for 4%, and a five-year ARM in the high-3% range – both lower than the market rate for a 30-year fixed conforming loan. “If you know you’re going to move in 10 years, you shouldn’t look at refinancing into a 30-year fixed loan, because you can get a lower rate and have the safety of 30-year in a 10-year ARM,” says Brown.

Just keep in mind that your payment is going to change down the road to adjust to going market rates – and the probability is that they’ll be higher. Though if you move in five years, you’re going to be in the market for a new mortgage anyway, and if rates tick up, you’ll have to pay that higher rate. So you’ll be in the same position had you not decided to refinance, says Guttentag.

15-year

Another option for certain borrowers is to refinance from a 30-year into a 15-year fixed-rate loan, which could save tens of thousands of dollars over life of the mortgage.

Ruzicka, who's had success doing this with several clients recently, says this isn't for homeowners who are struggling with their monthly payments. "In this case, we're not looking to save on the payment – we're looking to save on the interest of the loan," he says.

Ruzicka's client, a couple, was paying $875 a month on a 30-year year loan at 5.75%. Their loan amount was about $144,000, and he was able to refinance them into a 15-year fixed rate mortgage at a much lower rate of 4.25%. Their monthly payment (principal and interest only) increased to $1,087. But with the significantly lower rate, Ruzicka shaved 10 years off their loan term. And they'll be saving more than $90,000 in interest costs over the life of the loan, while their closing costs (the actual cost of the refinance) – which came to $1,387 – will be recouped in about eight months, says Ruzicka.

Crunch the numbers using our *calculator* [2] to help you decide whether to refinance.

[1] http://www.smartmoney.com/personal-finance/real-estate/4-costly-fees-to-watch-out-for-when-refinancing/
[2] http://www.smartmoney.com/personal-finance/real%20estate/should-you-refinance-9695/

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