The WHY, HOW and WHEN to REFINANCE

by John D. Maida, Attorney-at-Law (January 2016)

Thirty years ago I first drafted a newsletter to address why, how and when to refinance. How the world has changed since then! Today as rates threaten to return to the historical lows of 2015, just as in 1986, refinancing may for many generate immediate savings. This newsletter will, as I did in 1986, set forth my opinions for consideration on this subject.

Why Refinance: Because the lower the interest rate, the less it costs to borrow money. ***Therefore, when the cost to refinance can be recovered before the sale of a property, it is time to refinance.*** Consider the following example:

The Smiths', in 2008 purchased a home for $440,000.00 utilizing a mortgage loan of $352,000.00 at 6% interest, payable over 30 years. The Smiths' home is presently valued at $480,000.00 and they plan to sell it in five (5) years. The balance of the loan due on the property is $320,000.00. Should they refinance to a lower rate of 4%?

Many factors must be considered, as although the monthly savings may be substantial, the Smiths' will incur considerable refinancing cost. In our example, if the Smiths' refinance a new loan of $320,000.00, I estimate the cost to be $ 3,120.00. [1] Therefore, to justify refinancing, the cost ($3,120.00) must be recovered before the property is sold. In other words, the costs the Smiths' incur must be recovered before they sell the property in five (5) years.

By simply therefore dividing the closing cost of $3,120.00 by 60, i.e. the number of months the Smiths' will remain in the home, and adding the resulting sum of $52.00 to the new monthly mortgage principal and interest payment[2], the Smiths' will determine the "threshold amount" and if refinancing is justified**.** If the resulting "threshold amount" is less than the Smiths' current interest mortgage payment, it is time to refinance. If it is not, refinancing is not economically justified. In the example, the Smiths' will save approximately $330.00 in interest each month, and they will recover their cost in 10 months. They should refinance.

How to Refinance: Whether you are buying or refinancing, the loan process is similar. As with purchases, the Lender must estimate costs. ***Consider in addition to the interest rate, all other charges associated with the loan and the funds necessary to pay off your present loan. Ask your lender to compare the costs and rates for the various loan products being offered, e.g. both fixed and adjustable rate loans.*** Investigate the reliability, experience and reputation of the Lender. Select the Lender that is best suited to this financial endeavor.

Once a loan product and Lender are selected, it's time to orchestrate closing. All Lenders will offer assistance in this selection. Many of the service providers, but not all, the Lender must select. Note that the cost imposed by service providers also varies.

The premium and costs for title insurance will be among the most costly, so insist on being able to shop for the best service and lowest costs. ***Regardless of what many are told or may believe, title insurance costs (that include premiums) and services are not all the same. In most cases, the selection of a title company[3] and agency is yours - so choose wisely.***

When to Refinance: When all factors have been considered and tell you: **"I will save money by refinancing"-- it is time to refinance.**

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[1] Be careful as "no cost" refinance loans may simply have built their cost into a higher interest the rate for the loan.

[2] Do not add in escrow deposits, e.g. insurance and taxes, in this calculation, as they are generally unaffected by the transaction

[3] Example, Conestoga Title Insurance Co. offers an inflation endorsement at no cost on purchases of a owner occupied residence, others do not.