



To Refinance or Not? That is the question.

When you refinance your mortgage, you usually pay off your original mortgage and sign a new loan. With a new loan, you again pay most of the same costs you paid to get your original mortgage.

These costs may include settlement costs, discount points, and other fees. You also may be charged a penalty for paying off your original loan early, although some states prohibit this.

The total expense for refinancing a mortgage depends on the interest rate, number of points, and other costs required to obtain a loan. To obtain the lowest rate offered, most mortgage companies will charge several points, and the total cost can run between three and six percent of the total amount you borrow.

For example, on a \$100,000 mortgage, the company might charge you between \$3,000 and \$6,000. However, some companies may offer zero points at a higher interest rate, which may significantly reduce your initial costs, although your payments may be somewhat higher.

PAYING POINTS FOR A LOWER RATE

In refinancing, a mortgage company usually offers a range of interest rates at different amounts of points. A point equals one percent of the loan amount. For example, three points on a \$100,000 mortgage loan would add \$3,000 to the refinancing charges.

Analyzing various interest rates and associated points may save you money. As a rule of thumb, however, each point adds about one eighth to one quarter of one percent to the interest rate the mortgage company is offering.

Generally, the lower the interest rate on the loan, the more points the lending institution will charge. Some companies offer refinancing with no points, but generally charge higher interest rates.

To decide what combination of rate and points is best for you, balance the amount you can pay up front with the amount you can pay monthly. The less time that you keep the loan, the more expensive points become. If you plan to stay in your house for a long time, then it may be worthwhile to pay additional points to obtain a lower interest rate.

Some companies may offer to finance the points so that you do not have to pay them up front. This means that the points will be added to your loan balance, and you will pay a finance charge on them. Although this may enable you to get the financing, keep in mind that it also will increase the amount of your monthly payments.

HOW TO DECIDE

Traditionally, the decision on whether or not to refinance has usually meant balancing the savings of a lower monthly payment against the costs of refinancing.

In recent years, companies have introduced "no cost" and low cost refinancing packages that minimize or completely eliminate the out-of-pocket expenses of refinancing. (These refinancing packages compensate with a higher interest rate, or by including some of the costs in the amount that is financed.)

For the refinancing to make sense, the interest rate for your new mortgage must be about 2 percentage points below the rate of your current mortgage. However, with the newer low and no cost refinancing programs, it can be worth your while to refinance to obtain a smaller reduction in interest rates.

An important factor to consider is how long you expect to stay in your home. If you plan to move in a few years, the month-to-month savings may never add up to the costs that are involved in a refinancing.

REFINANCE CONSIDERATIONS

Keep in mind several issues when you are making your decision:

1. First, even a small rate cut can pay off quickly. That's because you can easily find mortgage companies willing to waive routine refinancing charges such as application, appraisal and legal fees (which can add up to \$1,500 to \$3,000). Of course, in exchange for low or no up front costs, you'll have to be willing to accept a rate that's somewhat higher than the prevailing rock bottom.

2. Second, if you are planning to stay in your home for at least three to five years, it may make sense to pay "points" (a point equals 1% of the loan amount) and closing costs to get the lowest available rate.

3. And third, you can avoid laying out cash and still get a low rate by adding the points and closing costs to your new mortgage. This does not necessarily mean you'll be shouldering a lot of debt. If you've had your current mortgage for at least three years, you've probably reduced your balance by several thousand dollars. You may be able to tack your closing costs onto your new loan and still end up with a mortgage that's smaller than your original loan -- plus, of course, a lower rate and lower monthly payment.

DOING IT AGAIN!

Even if you have previously refinanced, it may make sense to do so again. The Joneses (not their real names) from Kirkland, WA refinanced twice within three months in 1998. In October, they trimmed the rate on their 30-year fixed mortgage by a full point -- from 9.13% to 8.13% -- for a monthly savings of \$63.

Plus, because home prices in their area had boosted their home equity, they were able to stop paying private mortgage insurance that cost them \$120 a month.

To exploit the continued decline in rates, the Joneses refinanced again in December. Their new 30-year fixed mortgage is at 7.375%, cutting another \$55 off their monthly bill.

Since the couple had chosen a no-cost refinancing each time, their total out of pocket expenses came to just \$400 in appraisal fees. By the time you read this, they will already have recouped their up front costs.

SHOULD YOU REFINANCE, OR NOT?

Remember your goals. The Joneses had very specific goals for refinancing. As their family grew, their goal was to build a cash emergency fund.

Another important point to consider in a second refinancing is the potential tax-write-off: When you pay points to refinance, you must deduct the amount over the life of the loan, usually 30 years.

But when you refinance a second time, all of the points that have not yet been deducted from the first refinancing can be written off in a lump sum.