VANTAGE FINANCIAL PARTNERS LIMITED

TIME TO REFINANCE?

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Homeowners fretting about the declines in their investment portfolios and home values can find a bright spot in this economy -- mortgage rates are again near historic lows. But unlike the days of old, it may not be as easy to obtain a favorable rate mortgage. Good credit, generous home equity and the ability to make mortgage payments are key components of getting your application approved.

Convert to a fixed rate

For those who have an Adjustable Rate Mortgage (ARM), today's lower rates may offer a great opportunity to lock in a fixed rate 15, 20 or 30 year term mortgage. Consider this option even if your ARM is not yet due to expire. Waiting just before your rate resets can be a gamble as there is much room for rates to go up than to come down.

Shorten your mortgage term

Consider maintaining the same monthly payment and reduce the term of your mortgage. A $210,000 mortgage (30 year at 6.25%) taken in May, 2004 costs you $1,293 a month. Refinancing the remaining balance of $200,000 at 5.50% in February, 2008 would drop your payments to $1,167.15 – a difference of $125.86 per month. If you were to continue with your original payments of $1,293.01 on your new mortgage, it would be paid off in ~ 23.5 years vs. the 26 years remaining on the old one (31 months sooner than the original 30 year term).

Consolidate consumer debt

Refinancing can also offer you the opportunity to consolidate consumer debt such as credit cards or auto loans - possibly enabling you to deduct the interest on your taxes. Contact your tax advisor for further information on this deduction.

This may seem odd but some of the items listed above as benefits may also be considered drawbacks. It is essential to manage debt and, specifically, your new mortgage well. Let me explain:

Depleting equity

Millions of homeowners use their home equity as a bank account. They draw down equity to pay off credit cards, buy cars, purchase furniture, etc. With the recent declines in real estate values many are experiencing negative equity - their homes are worth less than the balance on their mortgage. Refinancing to consolidate debt can give you a false sense of security. Be careful not to use the freedom of being out of debt to repeat the cycle and build up consumer debt again.

Closing costs

Many borrowers forget that there is a cost associated with refinancing – usually about $1,200 to $1,600. If you choose a "no closing cost" mortgage, you will probably pay a higher mortgage rate to offset the fees paid by the broker/lender. Don't forget to include these costs as you weigh the decision to refinance.

Extending duration

Refinancing a mortgage that you've had for the last 5 or 10 years will increase the total number of payments because you are basically starting from scratch. Refinancing the 30 year mortgage you took out in 1998 to a new 30 year will ultimately mean 40 years of payment vs. the original 30 -- unless you follow the sample above and make additional principal payments.

Is it worth refinancing?

The key to knowing whether you should refinance is calculating your breakeven period. Determine how long it will take you to recover the cost of your refinance. Several variables should be analyzed – the number of years you have already paid, years you plan on staying in your home, interest rates, your income tax bracket and the cost of refinancing. Just dividing your monthly savings by your closing costs to determine the number of months it takes you to recoup these costs is not sufficient. You need to calculate the long term savings associated with your current mortgage vs. the new one. Several online financial calculators can assist you with the analysis. One that I've found beneficial can be found on Professor Guttentag's website at www.mtgprofessor.com.

As an example, to determine if refinancing makes sense if you continue to pay your current higher payment, you must consider how many fewer months you will be paying on the new mortgage. Don't forget to discount future dollars and bring them into today's equivalent.

In our example above, the present value of the 31 months of savings is only $7,092 in today's dollars (using a 7% discount rate) even though it represents $36,571 in future dollars.

Also, please keep in mind that these calculations assume you will be in your home for the life of the new loan.

When not to refinance

There comes a time when your current mortgage has aged to the point where the bulk of your monthly payment is applied to principal as opposed to interest. Refinancing it to start over from scratch usually doesn't make sense even if the rate reduction is significant.

If you plan on moving before recouping your closing costs, it doesn't make sense to refinance unless you are locking in a fixed rate to avoid a future rate adjustment.

Many factors must be considered before making the decision to refinance. Contact your Vantage Relationship Manager if you have specific questions about your mortgage and whether refinancing will be beneficial to you.