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The Refinance REPORT

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Everything You Need to Know When Considering a Refinance

With interest rates at historical lows, many people are refinancing their mortgage. Despite what most people believe, lower rates are not the only indicator in determining if it makes financial sense to refinance. Every situation is different and it's important to consider the important questions: Why Refinance? When to Refinance? How to Refinance?

Why to Refinance - The Top 5 Reasons to Refinance Your Mortgage

1. **Lower Rate** – This is the most obvious and the most popular reason why someone would refinance. However, 2 important questions to ask 1) how long will you remain in this home and 2) how much lower does the rate need to be to make it worth the cost to refinance?
   The general rule of thumb is if you KNOW you will NOT keep this loan for more than 2 years, refinancing will not make financial sense to you because there will not be enough time to recoup the cost spent to refinance. Secondly, the interest rate must drop by at least 1% for the monthly savings to generally make sense. Now of course the "rule of thumb" we use here may not hold true with very large and very small loan amounts. For example with large loan amounts, you may see substantial monthly savings at a .5% decrease in the interest rate and for smaller loan amounts you may not see substantial savings at a 1% decrease in the interest rate.

2. **Consolidating Debt** – Many people use the mortgage on their property as a vehicle to consolidate debt. For those lucky few that do have equity and also have debt (student loans, credit cards, cars, etc), this can be a phenomenal way to transfer your debt from a high interest rate to a much lower interest rate and now tax deductible interest. This can save people thousands of dollars per month!

3. **Pulling Out Equity** – Why would someone just want to pull out the equity in their home in the form of cash? Well there are many good and bad. One of the most popular

reasons is to leverage. The interest rate and fees on a primary residence will always be the least expensive. Rather than getting another higher interest rate loan to buy an investment property or home equity line of credit (HELOC) to remodel, the existing equity in the primary residence can be leveraged to accomplish the same goal at much less of a cost. Other people understand that while the bank does not pay interest on the equity in their house, they can pull this money out and put it in vehicles that will pay interest (this is for the more savvy investors and not something I would recommend to a beginner investor).

4. **Getting into a more secure loan** – For all those people who currently have adjustable rate mortgages (ARMs) or balloon loans, they want to take the opportunity to get into a more "safe and secure" loan like a 30 year fixed loan.

5. **Adding/Removing someone from the loan** – unfortunately with divorce rates climbing this is becoming a more popular reason to refinance. While you can transfer someone, on or off the title to your home without paying to refinance the loan, you cannot transfer someone on or off the loan. When approving a loan, the underwriter must review the income, assets, employment of everyone on the loan prior to granting the final loan approval. By removing someone off the loan, the underwriter must re-review that the person remaining on the loan can afford to continue to make payments. Unfortunately, anytime a refinance is done, the loan is subject to current interest rates.

While there are many reasons to refinance it's important to know all options before refinancing the mortgage on your next Denver home.

When is the Right Time to Refinance?

It's important for you to understand how to determine if refinancing makes financial sense for you. Never a good idea to blindly trust the mortgage lender's opinion – they only make money if you do actually refinance. As mentioned above, as a rule of thumb, the new interest rate should be decreased by at least 1% in order for the refinance to make sense; however, will vary depending on loan type and loan amount. For example, if your loan amount is $250,000, a .5% decrease in your interest rate may result in enough of a monthly savings for it to make sense to go forward with the transaction. On the other hand, a loan amount of $100,000 would need a larger reduction in interest rate to see any substantial saving benefit. Let's take a look at the example below to help you in crunching your own numbers.

EXAMPLE

*** the below numbers and figures are for the example only and not to be considered a market quote.**

Current Monthly Payment (refer to your current mortgage statement)
Current PITI (principal, interest, taxes, insurance): $2,158 at an interest rate of 6.5%

Proposed Monthly Payment (you will receive this information from your mortgage lender)
Principal & Interest: $1,810.08 at an interest rate of 5.5%
Estimated Taxes: $150.00
Estimated Insurance: $66.00
Total PITI: $2,026.08

Monthly Savings: $131.92

Estimated Closing Costs : $2500 (you will receive this info from your lender)

Calculations

closing costs ($2500)/monthly savings ($131.92) = breakeven month (19 months) = if you're going to have this loan for longer than 19 months, refinancing makes financial sense.

This is a VERY conservative way of crunching the numbers and assuming you are paying the closing costs out of pocket. Remember you can roll in the closing costs into your loan. If you rolled in the closing costs on this example you would have no out of pocket expense and your monthly savings would be $125 - making your break month the first month!

Financing closing costs versus no closing costs?
Many mortgage companies out there would like you to believe that there are no closing cost loans when, in fact, that just doesn't exist. Throughout the loan process, there are costs incurred that have to be paid, such as credit report, appraisal, title fees, doc prep fees,

processing fees, etc. There are basically only two ways these get paid: 1) the closing costs will be financed in your loan amount so you won't have to pay out-of-pocket money at closing, or; 2) the interest rate is increased to cover all the costs associate with the transaction. To determine the best way to pay for this, you must first determine how long you plan on keeping the new loan or keeping the property. For example, if you plan on keeping the loan for a minimum of 5 years, it would not make sense to pay a higher rate because over the course of time you will pay more than just financing the costs into the loan amount. However, if you plan is short term, less than 5 years, paying a higher interest rate may make more sense and save more money. A good mortgage consultant will present you with all your options and help guide you to the right decision.

Different Types of Refinances

There are many types of refinances available to you. Below is a list of them and a brief description of the purpose of each one:

Cash Out Refinance: this allows you to access your home's equity and pull cash out to pay for things such as home improvements and debt consolidation.

Rate & Term Refinance: this allows you to simply re-calculate your mortgage at a lower interest rate resulting in lower monthly payments and monthly savings.

Streamline Refinance: this allows anyone with a FHA loan to simply reduce their interest rate and monthly payments without the hassle of re-verifying income, assets, full credit disclosure and an appraisal.

IRRL (VA rate reduction): this allows anyone with a VA loan to simply reduce their interest rate and monthly payments without the hassle of re-verifying income and assets. In some situations you may even have the ability to waive the appraisal.

How to Refinance – 9 Steps in Refinancing your Mortgage

1. How much will I save, if I refinanced my mortgage? So important to first determine how much you will save by refinancing, before you even start this process. Send your most recent mortgage statement to your mortgage lender. Make sure they know your goals e.g.do you want a fixed loan or an adjustable rate mortgage (ARM), do you want to pull

cash out, do you want to consolidate debt, do you want to pay closing costs out of pocket or roll into the loan.

2. Review Closing Costs – There are many numbers that you will see on the estimate you receive from your mortgage lender. Some are actual fees and some are prepaids (e.g. taxes, home insurance, interest). When reviewing the estimate from your mortgage lender make sure you understand which are fees and which are prepaids. Prepaids are what they are and will remain the same regardless of the lender. The closing costs are the fees that can vary from lender to lender. The other thing to keep in mind, no cost refinances do NOT exist. There is always a fee in refinancing. The bank may absorb the closing fees by providing you with a higher interest rate. Make sure to ask your mortgage banker the options you have to minimize closing costs with a higher rate or to minimize the rate with higher closing costs. Remember the longer you are going to stay in your home, the lower you want the interest rate.
3. Do the numbers make sense? When looking at the options provided by your mortgage lender, ask yourself the following questions 1) How long will I keep this loan 2) What is the actual cost of the refinance 3) can I roll in the cost to refinance back into the loan 3) With the monthly savings, what month will I break even on the cost to refinance (see above section on how to calculate numbers)?
4. Submit an application – this will take 5-10 minutes and can be done securely online without verbally sharing all your financial details with those around you.
5. Credit Pull – once you've submitted your application, your credit will be pulled to verify you have the credit score required to obtain a new loan. At this point the interest rate and fees may change if your score is lower/higher than you originally told your mortgage banker. For the most ideal interest rate and fees you need a middle credit score of 740.
6. Submit paperwork – your mortgage lender will provide you with a checklist of documents needed to submit your loan to underwriting. Make sure to provide all pages to every asset statement and that all required documents are legible.
7. Order Appraisal – Once all paperwork is reviewed and verified the appraisal will be ordered. This is a third party entity valuating your property. It's important to note that the appraised value is crucial to the success of your refinance. If appraisal comes in lower than anticipated, you may have to bring money to close the refinance or the loan may be denied. If the appraised value comes in higher than anticipated you may have the ability to pull more cash out.
8. Underwriting – the underwriter reviews your application, income, asset, employment documentation along with the appraisal. The majority of the time, the underwriter will

provide a conditional approval which means you are approved as long as you can satisfy the following conditions e.g. recent paystub, bank statement, etc.

9. Closing – once the underwriter provides the final loan approval, you are able to close your new loan. The closing process generally takes about 45 minutes from beginning to end. With refinances on primary residences, there is always a three day right of rescission. This means you have 3 business days (counting Saturday) for your refinance to be finalized. In those 3 days of time you can cancel the refinance. For those of your pulling out equity, it is important to note you will not receive the check until the 4th business day.