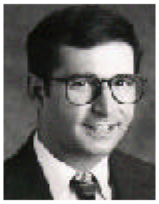

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Refinancing Your Personal Residence Mortgage

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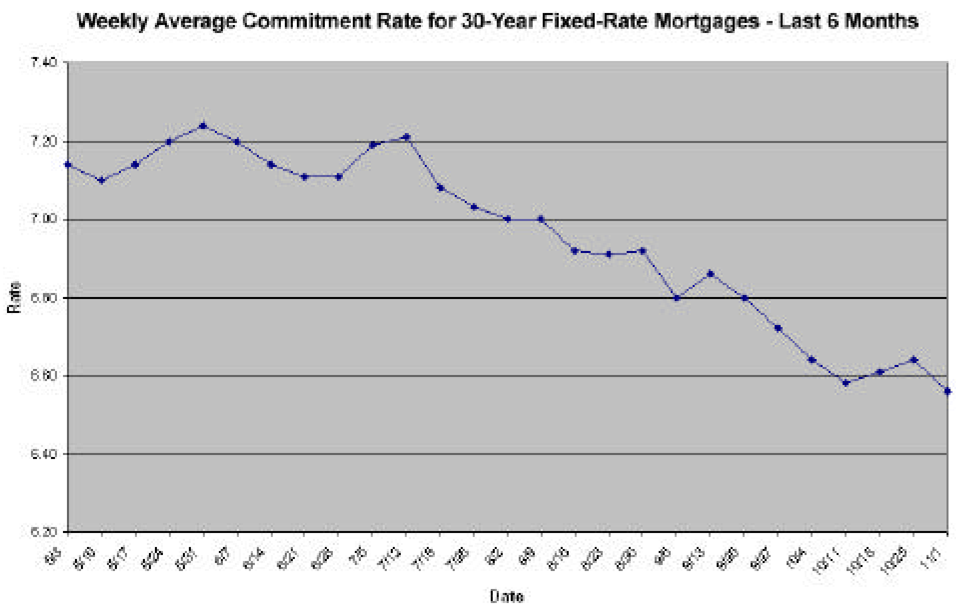
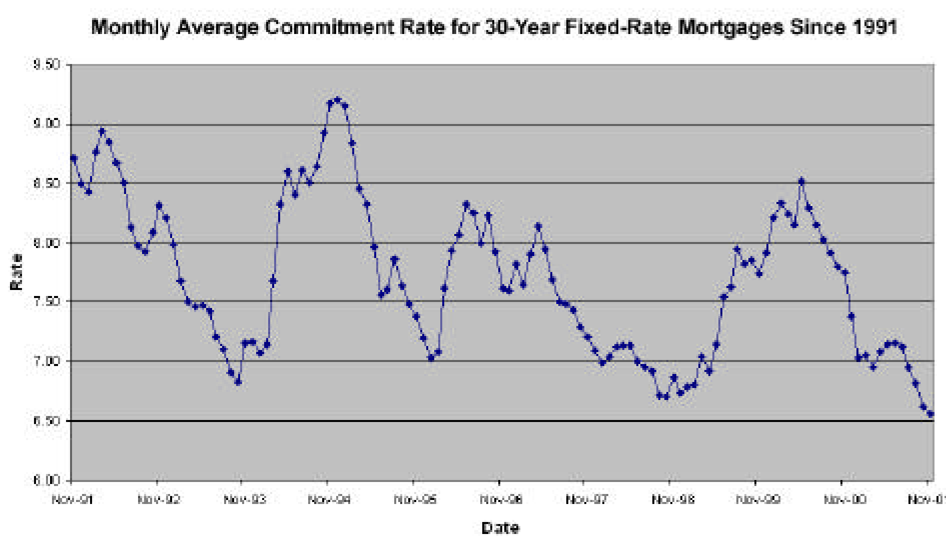
Now is the time to consider refinancing your personal residence. On November 16, 2001 several mortgage companies advertised rates in the 6% range with no points on a 15-year-fixed mortgage.





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You should consider refinancing if:

- You can find a new fixed rate loan at least one and preferably two percentage points or more lower than your current mortgage interest rate.
- You have an adjustable-rate mortgage and you want to convert to a fixed-rate loan to guard against future increases in the interest rate. (Adjustable rate mortgages are usually more attractive when interest rates are high.)
- You have other higher interest debt that you can convert to lower interest tax-deductible debt, by increasing the size of your mortgage and paying off the higher non-deductible interest debt.
- You want cash. Be advised that in the context of refinancing:
  cash = loan amount – (debt to be paid off + closing costs).

  Conventional uses for the cash from refinancing include:

  - Paying off non-tax-deductible higher interest debt such as credit cards, school loans, car loans, and other consumer debt or, in some cases, business debt.
  - Using the funds to remodel your residence.
  - Paying your income taxes.
  - Paying for personal expenses, including large and small purchases.
  - Any use you choose; there are no restrictions on the use of this money.

  Unconventional uses for the cash from refinancing include:

  - Paying the tax on a Roth IRA conversion (an aggressive, but interesting strategy).
  - Using the funds to take advantage of investment opportunities.
  - Using the cash to cover living expenses to avoid liquidating stock investments.
  - Free up cash for gifts.

You are probably *not* a great candidate for refinancing if:

- Most or your entire mortgage is paid off and you have no compelling use for the money.
- Your current mortgage interest rate is already low.
- A realistic cash analysis indicates there may be a problem paying the mortgage in the future.

Bob Danenberg, Pittsburgh real estate attorney, cautions that the decision to refinance should not be based solely on rates and points. Before Bob recommends refinancing for his clients, he wants to know their entire debt structure, how long the client plans to stay in the house, and how long will it take to recoup the costs of refinancing.

What Type of Loan Should You Consider?

Without a doubt it pays to shop around and ask questions.

First you should decide what type of loan you want and what type of loan is appropriate for your situation. My vote in most cases is the 15 or 30-year conventional fixed rate loan.

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Though you could do a little bit better initially with an adjustable rate, I like the certainty of a fixed rate, particularly at these bargain prices. Though your payments will be lower with a 30-year than a 15-year, I prefer the lower interest rates of a 15-year mortgage. A 15-year conventional mortgage of less than $275,000 will have a lower rate than a jumbo mortgage ($275,000 or more). A 30-year fixed, though it will have a higher rate than a 15-year fixed, is also a good choice because of the low payments.

Points and Interest Rates

A "point" is a term used to describe a fee charged by the lender for a mortgage. One point is generally equivalent to 1% of your mortgage. When you pay points, you are effectively paying interest up-front. Providing the cash up-front confers an advantage to the lender *and*, in return, the lender can offer you a slightly reduced mortgage rate for the term of the loan. If you do not pay points, the interest rate will be higher. Gordon Peterson, loan officer for www.windsorfinancial.com, says as a rule of thumb: a point changes the interest rate by about one-eighth to one-quarter of one percent.

The bottom line in my opinion is: *Don't pay points. It isn't worth it*. Let me show you: www.nolo.com provides a loan comparison calculator that I used to compare three of the top rates offered on November 9, using a $100,000 15-year fixed-rate mortgage.
The table indicates what the point(s) will cost, and the monthly savings each one generates in contrast to the 0 point loan. As you can see, it takes a very long time to recover the cost of the point(s) and the interest rate reduction only reduces your monthly payment by a very small amount. By paying $1,000 for one point, you reduce your interest rate by ¼ % and you receive a monthly savings of $13.33 over the 0 points loan. It will, however, take more than six years to recoup the cost of that point. It will take over eight years to recover the cost of the 2-point loan. My own simplified cheapskate analysis is that I don't want to pay points, period! Even when I run numbers proving that the break-even point may be 6-8 years on any particular loan, *I still don't want to pay points*. The future is volatile, and you may want to refinance again or sell before the "break-even" period passes. Obviously, the more likely you are to move or refinance in the future, the more prudent it would be to avoid paying any points.

Tax Deduction for Points

The tax deduction for points is miserable. IRS regulations require that interest (points) paid up front for refinancing must be deducted over the life of the loan—not in the year you refinance—unless the loan is for home improvements. This means that if you pay points, and the refinancing is *not* for home improvements, you have to spread the tax deduction for those points over the life of the loan.

Recouping Refinancing Costs

Some Internet sites, e.g., www.nolo.com and www.quickenloan.com, offer sophisticated calculators that allow you calculate the potential savings from a lower interest rate mortgage. They also calculate your "break-even" point, or the time it will take to recoup the up-front costs of the refinancing. Let's assume you have a 15-year mortgage with a balance of

$200,000 at a fixed rate of 7%. Should you refinance to 5.75% (a savings of 1¼ %), with $3,270 closing costs and 0-points? If you plug these numbers into a refinancing calculator, you discover that your monthly savings will be $137. Dividing the up-front fees by the monthly savings ($3,270 / $137 = 24 months) indicates that it would take two years to recoup your closing costs. If you stay in your house for the full 15 years, you will save $8,765 over the entire loan period. (This value is the present value, using an investment rate of return of 5% and an income tax rate of 28%.) Assuming you plan to stay in your house beyond the break-even point, refinancing this mortgage is a "no brainer."

Keep in mind that the size of the loan plays an important part in determining whether it makes sense to refinance. Some of the loan costs and fees vary with the loan size, but most do not. Smaller loans have nearly as high up-front costs *and* lower monthly savings. Smaller loans do not have the same advantage as larger loans when it comes to refinancing. Bob Danenberg remarks that where the costs and fees in our example above came to approximately $3,270 (in Pennsylvania) for a $200,000 fixed rate loan with no points, they would be only $500 less for a $100,000 loan with the same terms. Nolo.com's calculator shows that the monthly savings for refinancing a $100,000 loan from 7% to 5.75% would be $68 (half that of the $200,000 loan). The break-even period for this loan would be nearly 3½ years ($2,770 / $68 = 41 months), compared to the 2-year break-even period for the $200,000 loan.

Shopping for a Mortgage

Once you decide to refinance, it is time to go shopping. Contact your banker, look in the paper, contact a mortgage broker or look on the Internet. Right now is probably the busiest refinancing market of all time—don't anticipate quick service. Suze Orman, best selling author of personal financial books, says that the most reliable loan sites are www.eloan.com, www.lendingtree.com, www.reatlytimes.com and www.quickenmortgage.com. I would also recommend www.bankrates.com. Please understand however, that in a situation where you must close on a certain day (like for the initial purchase or a situation where you need the cash), an Internet company may not be a wise choice.

Even after finding the best rate, ask your current lenders about their best offer. They may have some incentive programs to retain current borrowers. I looked for the best deal on the Internet at www.bankrates.com and brought the offer to my local banker who could not meet the offer I had. If you are concerned about a particular lender, call your state's Department of Banking to see if the lender is properly licensed, or if any complaints have been filed against them. Here are several state web sites to browse in connection with licensing or complaint issues:

http://www.banking.state.pa.us/
http://www.banking.state.ny.us/
http://www.dfi.ca.gov/
http://www.azbanking.com/
http://www.dbf.state.fl.us/

Escrow Accounts and Waivers

Depending on the lender, you may be required to put money into an escrow account that

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will be used to pay property taxes and insurance. Your monthly mortgage payment is increased by some fraction to fund the escrow account. Alternatively you can pay your own taxes and insurance as they come due. That is my preference.

I don't like escrow accounts for two reasons:

1. When the mortgage company is holding your money, you are losing interest.
2. I trust you more than a mortgage company to stay on top of your taxes and to take advantage of early payment discounts, etc.

Many lenders will require you to pay an "escrow waiver" for the privilege of allowing you to pay your own real estate taxes and insurance. Though I don't think it is a fair charge, it is probably smart for you to pay it to have the escrow requirement waived.

Interest rates are the lowest they have been for years. Please take a few minutes to evaluate your personal circumstances to determine if refinancing makes sense for you. For the right homeowner, refinancing your personal residence may save you a lot of money.

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