Refinancing My Mortgage: How Much Will I Save?

Refinancing your home mortgage is becoming quite popular these days, given the lower mortgage rates that are currently available. But, does refinancing make sense for you? The answer depends on a number of factors including but not restricted to: your tax bracket, the length of time you plan to stay in your home, and the costs you must pay for the refinancing. By definition, when you refinance your mortgage, you oftentimes pay off your original mortgage and sign a new loan. With your new loan, you again pay most of the same costs you paid to get your original mortgage including settlement costs and discount points. In addition to other fees, keep in mind that you could 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 by the lender requires taking a step back. Look at the big picture. Lenders will charge several points, and the total cost can run between three and six percent of the total amount borrowed. For instance, the lender might charge you between $5,000 and $10,000 on a $150,000 mortgage. However, some lenders may offer zero points at a higher interest rate, which may significantly reduce initial cost, although your payments may be somewhat higher.

Is the interest rate low enough to save you money?

Talking to lenders and determining the available rates and the costs associated with refinancing is essential. These costs often include appraisals, attorney's fees, and points. Using these figures, determine what your new payment would be if you refinanced. Estimate how long it will take for you to recover the costs of refinancing by dividing your closing costs by the difference between your new and old payments (your monthly savings). Keep in mind, however, that the amount you could save depends on many factors, including your total refinancing and the effects of refinancing on your taxes.

It's been said you shouldn't refinance unless the new interest rate is at least two percentage points lower. However, that isn't so much the case today. Many lenders are now offering zero point loans and low-cost refinancing so even if your rate change is less than one percentage point, you may be able to save some money by refinancing.

How many "points" must you pay to the lender?

Lenders usually offer a range of interest rates at different amounts of points with refinancing. A point equals one percent of the loan amount. For example, two points on a $100,000 mortgage loan would add $2,000 to the refinancing charges. Therefore, shopping for points can save you a lot of money.

Generally, each point adds about one-eighth to one-quarter of one percent to the interest rate the lender is offering. The lower the interest rate on the loan, the more points the lending institution will charge. Naturally, lenders offering refinancing with no points will charge higher interest rates.

Deciding what combination of rate and points is best for you is key. 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. Another factor you must consider is the length of time you plan to stay in your home. If you plan to stay in your house for a long time, then it may be worthwhile to pay additional points to obtain the correlating lower interest rate. Thinking about your general time frame will save you money in the short or long-term.

Sometimes lenders may offer you the opportunity to finance the points so that payment can be delayed up front. What this means is that the points will be added to your loan balance, and you will have to pay a finance charge on them. Though this may enable you to get the financing, it will increase the amount of your monthly payments.

Settlement Costs

Settlement costs typically include fees for the loan application, title search, appraisal, loan origination, credit check, and lawyer's services. You also may be required to pay recordation fees or transfer taxes. If you are shopping for a lender, ask each one for a list of charges and costs you must pay at closing. Some lenders may require that some of these costs be paid at the time of application.

How does refinancing affect your taxes?

Your tax payments may increase with a lower interest rate on your home loan. The reason being, there is less interest to deduct on your income tax return. Ultimately, this decreases the total savings you might obtain from a new, lower-interest mortgage.

It is of utmost importance that you understand the Internal Revenue Service (IRS) ruling with regard to points paid solely for refinancing your home mortgage. 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. How this affects you is that if you paid a certain number of points, you would have to spread the tax deduction for those points over the life of the loan. If, however, the refinancing is for home improvements -- or a portion of the loan is for this purpose -- you may be able to deduct the points -- or a portion of the points -- under certain circumstances. Check with IRS regulations for more information.

Considering Refinance?

If you are thinking about refinancing your mortgage, you might want to consider other types of mortgages, like a 15-year, fixed-rate mortgage. With this plan, your mortgage payments are somewhat higher than a longer-term loan, but you pay substantially less interest over the life of the loan and build equity quickly. Refinancing if you have an adjustable rate mortgage (ARM) with high or no limits on interest rate increases could also be a point of consideration. Switching to a fixed-rate mortgage or to an ARM that limits changes in the rate at each adjustment date as well as over the life of the loan could be smart.

If you want to solidify an interest rate before closing, get a written statement guaranteeing the interest rate and discount points that you will pay. This written commitment protects you; the lender will not raise these costs even if rates increase before you close. Another point of considering is requesting an agreement where the interest rate can decrease but not increase before closing. If a lender is reluctant to put an agreement in writing, it is food for thought to find another lender who can.

Oftentimes lenders leverage negotiations by placing a limit on the length of time they will guarantee the interest rate. Because many people are refinancing their mortgages, there could very well be a delay in processing the papers. In this case, you would want to contact your loan officer to check on the progress of your loan approval.

How do you get started?

If you decide to refinance your mortgage, shopping around by calling several lending institutions will help you get the best available deal. Also ask each about their "annual percentage rate" (APR) - the APR will tell you the total credit costs of the refinancing, including interest, points, and other charges.

Remember that you are not obligated to refinance your mortgage with the same lender that provided your original mortgage. Naturally, however, in an effort to keep your business, some lenders will offer their original mortgage customers the incentive of lower mortgage rates and fees.

What information are you entitled to?

In refinancing, the lender must give you a written statement of the costs and terms of the financing before you become legally obligated for the loan, as required by the Truth in Lending Act. Look to receive the information around the time of settlement, although some lenders will provide it earlier. Review this statement carefully before you sign the loan! The disclosure details for you, amongst other things, the APR, finance charge, amount financed, payment schedule, and other important credit terms.

You also must be afforded the right to cancel the loan if you refinance with a different lender, or if you borrow beyond your unpaid balance with your current lender. In this case, you have the right to rescind the transaction within three business days following settlement, receipt of your Truth in Lending disclosures, or receipt of your cancellation notice, whichever occurs last.

Will you be refunded your application costs if you choose not to sign?

Some lenders require you to pay a special charge to cover the costs of processing your application. The amount of this fee varies, but ordinarily, you must pay this charge at the time you file the application.

Some lenders do not refund this application fee if you are not approved for the loan or if you decide not to take it. That being said, it is smart to ask lenders whether they charge an application fee. If so, find out how much it is and under what circumstances and to what extent it is refundable. In the case of electing to cancel the transaction within three business days after you close the loan, as discussed above, you are entitled to a refund of all costs and charges imposed for the credit transaction.

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