Refinance The Right Way

Home loan rates have been low for quite a while, so you may be tempted to refinance your mortgage and use the cash to pay off your higher interest debts. Mathematically, it sounds like a good idea.

But is it?

The Wrong Reasons to Refinance

Refinancing to pay off debt is risky because it means putting your home at risk. You are leveraging the place where you, your spouse and your kids sleep. If you lose your job or encounter financial difficulties, guess what you will lose?

That's not the only reason to be wary. The vast majority of people who take equity out of their home to pay off bills continue to overspend. That means the credit card balances are run back up, and when you combine that with your higher house note, you end up in double debt.

It’s also a bad idea to refinance to get cash to update your home. When you use your equity for any purchase at all, you are on the hook for that money. You owe it. If you don't pay, there will be trouble.

The Right Reasons to Refinance

Refinancing works best when you want to make a less-than-desirable mortgage better, not when you want to buy something with that money. Refinancing might be good if:

- You have an adjustable rate mortgage.
- You have an interest-only loan.
- Your mortgage term is longer than 15 years (such as 30, 40 or 50 years).
- You have a high interest rate.

In each of those scenarios, you are not refinancing your home for cash to spend elsewhere. You are modifying your current mortgage to more favorable terms, be it a lower interest rate or a shorter note. Your new payment should be no more than a fourth of your take-home pay on a 15-year, fixed-rate note.

The Break-Even Analysis

A refinance makes sense when you can lower your interest rate enough to pay for the closing costs before you plan to sell your home.

Here’s a simple example. If you have a $100,000 mortgage and you can lower your interest rate by 1% in a refinance, you'll save $1,000 a year. If your closing costs are $3,000, it will take three years to break even on your refinance.

In general, a refinance is worth it if you can lower your rate by at least 2%. At that point, you'll see real savings on your monthly payment.

If you're ready to refinance, work with one of Dave's real estate Endorsed Local Providers (ELPs). You can trust them to give you the same advice that Dave would. Get in touch with your ELP today!