



# Refinancing

## Refinancing

- What is it?
- Why refinance?
- When should you refinance?
- How do you do it?
- What will it cost to refinance?
- Are there any tax issues to consider?

### What is it?

Mortgage refinancing generally refers to the process of taking out a new home mortgage loan and using some or all of the proceeds to pay off an existing mortgage (or mortgages) on the property.

No-cash-out refinancing occurs when the amount of your new loan doesn't exceed your current mortgage debt (plus points and closing costs). With this type of refinancing, you may be able to borrow as much as 95 percent of your home's appraised value.

A cash-out refinancing occurs when you borrow more than you owe on your existing mortgage, allowing you to use the excess cash in any way you see fit (e.g., remodeling project, pay off high-interest debt). In this case, you are generally limited to borrowing no more than 75 to 80 percent of the appraised value of your property.

### Why refinance?

You've heard about the record-low interest rates. Now you're wondering whether you should throw your hat into the ring and refinance. Here are a few reasons why you may choose to do so:

- You may want to lower your monthly mortgage payment by refinancing to a lower interest rate
- You may be interested in refinancing to a lesser loan term (e.g., from a 30-year mortgage to a 15-year mortgage), allowing you to own your home free and clear in less time
- You may be looking to do a cash-out refinancing or tap into your home equity in order to access some extra cash for home improvements, pay for college, or consolidate debt
- You may want to refinance your adjustable rate mortgage (ARM) to a fixed rate mortgage or a new ARM with better terms

**Tip:** If you are refinancing because you want to tap into your home equity, you may want to consider other options, such as obtaining a home equity loan or opening a home equity line of credit. For more information, see [Home Equity Loans and Lines of Credit](#).

### When should you refinance?

An old rule of thumb said that you shouldn't refinance unless interest rates are at least 2 percent lower than the interest rate on your current mortgage. However, even a 1 to 1.5 percent differential

may be worthwhile to some homeowners.

Actually, a number of factors enter into the decision of when to refinance. The length of time you plan to stay in your current home, the costs associated with getting the new loan, and the amount of equity you have in your home must all be considered.

Ultimately, it makes sense to refinance if you're certain that you'll be able to recoup the cost of refinancing during the time you own the home. So, it's important to do the math ahead of time and calculate your break-even point (the point at which you'll begin to save money after paying fees or closing costs). It is often considered ideal if you can recover your refinancing costs within one year or less.

**Example(s):** Assume that by refinancing to a lower interest rate, you'll save \$75 per month on your mortgage payment. Your refinancing cost is \$3,600. You'll be able to recover that cost in four years (\$3,600 divided by \$75). So, in order for refinancing to be worthwhile, you'll need to stay in your home for at least four years. If you sell your home before that time, you really won't be saving any money.

**Caution:** If your break-even point is many years away, it may not be in your best interest to refinance.

**Tip:** Many lenders will calculate your break-even point to help you decide whether refinancing is right for you.

## How do you do it?

You'll first want to check with your current lender to find out what types of rates it offers for refinancing. Because you're a customer, your lender already has much of the necessary information for a refinance (e.g., your personal information, information on your current property). As a result, some of the typical fees associated with refinancing may be lower or may not apply.

However, a good interest rate and low fees aren't the only factors to consider. You'll also want to make sure you are satisfied with your current mortgage lender (e.g., customer service, consumer-friendly website) before you sign another loan with that lender.

If your lender isn't offering competitive interest rates or if you're not satisfied with how it has serviced your original loan, shop around among various lenders to make sure you're getting the best rate possible. In addition, you'll want to inquire about the types of fees each lender charges to refinance. Start out by searching the Internet. Many websites specialize in listing mortgage companies that offer the best rates. Also take a look at the real estate section of your local newspaper.

In effect, you're applying for another mortgage when you refinance. You'll have to fill out an application, provide the required documentation, and pay the required fees. You may also want to sit down with an attorney and have him or her review the final paperwork.

Sometimes, it can take up to two months for a refinance to be finalized. So, once you've found a lender, you may want to consider locking in a rate. While you may have to pay a fee to lock in a rate (and the longer the lock-in period, the higher the fee), some lenders may provide this service at no

additional charge.

## What will it cost to refinance?

Refinancing can often save you money over the life of your mortgage loan. However, this savings comes at a price. Typically, you'll need to pay an assortment of up-front fees, including points and closing costs. Some lenders often advertise "no points, no closing costs" refinancing deals, which roll the costs into your overall loan balance or charge a higher interest rate. Some typical closing costs include:

- Application fee
- Appraisal fee
- Credit report fee
- Attorney/legal fees
- Loan origination fee
- Survey costs
- Taxes
- Title search
- Title insurance

## Are there any tax issues to consider?

For federal income tax purposes, you are generally able to deduct qualified interest you pay on a mortgage to buy, build, or improve your home, provided that the mortgage is secured by your home and meets certain dollar limits. This is known as "home acquisition indebtedness" for tax purposes. Interest on new debt you incur to refinance your home acquisition indebtedness also qualifies, but only up to the amount of the refinanced debt.

**Example(s):** You buy a home for \$250,000 with a \$200,000 mortgage. The \$200,000 debt is acquisition indebtedness. Years later, when the mortgage balance is \$49,000 and the house is worth \$400,000, you refinance with a new \$200,000 mortgage. Only \$49,000 of this "new" debt is acquisition indebtedness (but an additional \$100,000 may qualify as home equity indebtedness).

**Caution:** The rules can be complicated. See Refinancing and Home Equity Loans: Tax Considerations for more information.

This communication should not be considered as an offer to sell or buy any securities, provide investment advice, or make investment recommendations. This information is being provided with the understanding that it is not intended to be interpreted as specific legal or tax advice. Individuals are encouraged to consult with a professional in regards to legal, tax, and/or investment issues. Advisory Services offered through Investment Advisors, a division of ProEquities, Inc., a Registered Investment Advisor. Securities offered through ProEquities, Inc., a Registered Broker-Dealer and member NASD & SIPC. 2801 Hwy 280 S, Birmingham, AL 35223; 800-288-3035.