



Opening Doors to Housing Success

Before you know if refinancing your mortgage will save you money, you need to decide how long you plan to live in the house. Then you can calculate the benefits of refinancing.

Will Refinancing Your Mortgage Save You Money?

Refinancing a mortgage is simply taking out a new mortgage to pay off the present loan on a home. People refinance loans for many different reasons.

- 🔑 The most common reason is to save money. If you can get a loan with a lower interest rate, your monthly mortgage payment and the total amount of interest you pay will be less.
- 🔑 You can also save money by reducing the number of years of your loan. For example, you may decide to change from a 30-year to a 15-year mortgage. Depending on the interest rate, your monthly payment may stay the same, or even increase. However, the total amount of interest you pay will be less.
- 🔑 Depending on interest rates, you may want to change from an ARM (Adjustable Rate Mortgage) to a fixed-rate mortgage. With a fixed-rate mortgage you know your mortgage payment will be the same amount each month.
- 🔑 Changing from one ARM to another ARM with a lower interest rate can save you money. Another reason to change ARMs is to get better protective features such as payment caps. A payment cap limits the number of times interest rates can be raised or the length of time between interest rate increases.
- 🔑 You may want to refinance to get money for other family expenses. For instance, you can use the equity or cash value in your home for a major expense such as a child's education or a remodeling project. You may want to refinance to consolidate debts or pay off high interest loans. Instead of these loan payments, you would have a larger mortgage but at a lower interest rate and the interest paid would be tax-deductible. However, be cautious about continuing to use your credit cards if you refinance because of potential debt problems.



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Tax Considerations

Under current tax law, the points charged when refinancing aren't all deductible from federal income tax in one year. The costs must be amortized over the life of the loan. To do this you must divide the amount of the points by the number of years of the loan. For example, if you have \$900 in points for a 10-year loan then you may deduct \$90 per year from your taxes (\$900 divided by 10 years equals \$90).

On an original mortgage the total cost of financing points is usually deducted in the year it's paid. An additional tax consideration is if the mortgage payment decreases with a refinanced mortgage then there'll not be as much yearly interest to deduct.

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For more housing information see other *Opening Doors to Housing Success* fact sheets.

Refinancing Costs

You need to find out how much refinancing costs. First, check to see if your present mortgage has any kind of prepayment penalty. Next, compare interest rates and loan types for at least three lending institutions. Find out what kinds of fees or closing costs are charged for a new mortgage. Fees for the appraisal, loan application, title search, title insurance, home inspection, and legal advice are common costs. Loan origination fees (also called points) are the largest closing cost you will pay. A point is usually one percent of the total loan. One point or one percent of a \$90,000 loan would be \$900.

Comparison of Refinancing Costs

	Lender 1	Lender 2	Lender 3
Application Fee			
Appraisal Fee			
Survey Costs			
Homeowner Insurance			
Title Search			
Title Insurance			
Loan Origination Fee or Points			
Home Inspection Fee			
Mortgage Insurance			
Lender's Attorney Fee			
Total			

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Figuring Out If Refinancing Saves Money

One of the important things to look at is how long you plan to live in the home. If you're refinancing to lower the monthly payments, do the following calculation to find out the time it will take until you meet the break-even point and start saving money. This analysis works if you're refinancing to save money on monthly payments or when refinancing a fixed-rate mortgage with a lower fixed-rate.

1. Calculate the total refinancing cost. Example: \$2000
2. Calculate how much you'll save each month on payments. Example: \$50 each month
3. Divide the total refinancing cost by the monthly savings to get the number of months you need to keep your home to break-even. Example: \$2000 divided by \$50 equals 40 months. In this case, you should consider refinancing only if you plan to live in the home for at least 40 months.

_____	divided by	_____	equals	_____
Refinancing costs		Savings per month on a mortgage payment		Number of months to break even

If you're refinancing to switch from an ARM to a fixed-rate loan, or from a 30-year loan to a 15-year loan, it's much more difficult to perform a break-even analysis. However, on the Internet there are financial calculators that can help you. For example, Fannie Mae has several useful calculators, <http://www.homepath.com>.

Zero-Point/Zero-Fee Mortgage Loans

Some lending institutions offer loans without points. Sometimes lenders even pay some of the other closing fees. You don't need to do a break-even analysis if you have no refinancing costs.

How can lenders afford to offer no-fee refinancing deals? The financial institutions hope that you'll live in your same home for several years. Interest rates on zero-point loans are a little higher, and the lender will recover costs after several years have passed.

One disadvantage of zero-point mortgage loans is that you'll pay a higher interest rate and, over the years, more total interest. On the other hand, zero-point/zero-fee loans are good if you plan to sell your home in two or three years. This is an attractive loan when you think interest rates will continue to fall and you may refinance again in a few years.