Understanding Re-Financing

Understanding the process of re-financing can be quite dizzying. Homeowners who are considering re-financing might initially be overwhelmed by the number of options available to them. However, after taking some time to educate themselves about the process, they will likely find the process is not nearly as daunting as they had imagined. This article will discuss some of the options available to those interested in re-financing as well as some of the important factors to consider in order to determine whether or not refinancing is worthwhile.

Consider the Options

Homeowners have quite a few options available to them when they are considering the possibility of re-financing their home. The most significant decision is the type of loan they will choose. Fixed rate mortgages and adjustable rate mortgages (ARMs) are the two main types of mortgages the homeowners will likely encounter. Additionally there are hybrid loan options available.

As the name implies, a fixed rate mortgage is one in which the interest rate remains constant throughout the duration of the loan period. This is an especially favorable type of loan when the homeowner has credit which is sufficient enough to lock in a low interest rate.

ARMs are mortgages where the interest rate varies during the course of the loan period. The interest rate is usually tied to an index such as the prime index and is subject to rises and falls in accordance with this index. This is considered a riskier type of loan and is therefore often offered to homeowners who have less favorable credit scores.

Although ARMs are considered somewhat risky there is usually a certain degree of protection written into the loan agreement. This may come in the form of a clause which limits the amount the interest rate can increase, in terms of percentage points, over a fixed period of time. This can protect the homeowner from sharp increases in the interest rates which would otherwise considerably raise the amount of their monthly payments.

Hybrid loans are mortgages which combine a fixed element with an adjustable element. An example of this type of loan is a situation where the lender may offer a fixed interest rate for the first five years of the loan and a variable interest rate for the remainder of the loan. Lenders typically offer a lower introductory interest rate for the fixed period to make the mortgage seem more enticing.

Consider the Closing Costs

The closing costs associated with re-financing should be carefully considered when deciding whether or not to re-finance the home. This is significant because when homeowners re-finance their home they are often subject to many of the same closing costs as when they originally purchased the home. These costs may include, but are not limited to appraisal fees, application fees, loan origination fees and a host of other expenses. These costs can be quite significant. The closing costs will be significant when the homeowner considers the overall savings associated with re-financing.

Consider the Overall Savings

When deciding whether or not to re-finance, the overall savings is one factor the homeowners should carefully consider. This is important because re-financing is typically not considered worthwhile unless it results in a financial savings. Although some homeowners refinance to lower monthly costs and are not concerned with the overall picture, most homeowners consider whether or not they will be saving money by refinancing.

The amount of money the homeowner will save when re-financing is largely dependent on the new interest rate in relation to the old interest rate. Other factors come into play such as the remaining balance of the existing loan as well as the amount of time the homeowner intends to stay in the home before selling the property. It is important to note that the amount of money saved by negotiating a lower interest rate is not equal to the entire savings. The homeowner must determine the closing costs associated with re-financing and subtract this sum from the potential savings. A negative number would indicate the new interest rate is not low enough to offset the closing costs. Conversely a positive number indicates an overall savings. With this information the homeowner can decide whether or not he wishes to re-finance.

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