03/18/2007

Refinancing Your Mortgage and Your Home Equity Loan

During the recent housing boom, many homeowners took advantage of soaring home price appreciation by taking out home equity loans. The additional mortgages allowed people to borrow up to a certain amount based on their existing home equity. They could then use the cash for things like home improvements, debt consolidation, college tuition, new car purchases, or other major expenses. Now that the boom has ended and home owners are left with less equity, many wonder if they should consolidate both their first mortgage and their home equity loan into a new refinanced loan. If you are in that camp, take a look at the information below.

Refinance Defined

A refinance loan basically means creating a new home loan to pay off your current mortgage. In this case, the loan would have to be large enough to pay off both your first mortgage and your home equity loan. Generally people like to refinance because they can save money either monthly or in the long run, by getting a lower interest rate or lower monthly payments. If you are considering consolidating your two loans into one, it is probably because you want to save some money. To determine if a refinance loan would be a better option than simply repaying your two existing loans, you need to consider several factors.

Interest Rates

First you need to think about the interest rates you currently have and the rate you could potentially get. Currently average mortgage rates are pretty low, with 30-year rates hovering around 6.15%, although your rate on a new refinance loan could be higher depending on the amount you borrow and your credit rating. Typically, home equity loans carry higher interest rate than traditional mortgages, anywhere from 2% to 5% higher. If you can find a refinance loan with an interest rate that is lower than both your home equity loan rate and your original mortgage rate, you will probably save money in the long run. That is, if you stay in you home for the long run.

How Long Will You Stay in Your Home?

Whether a refinance mortgage to cover both loans makes sense or not depends on how long you are going to stay in your current home. A refinance loan, like all other mortgages, requires closing costs and fess, and sometimes points. You have to factor these into the equation. You should figure out how long you need to stay in your house to make the savings equal your upfront costs. Let’s say you refinance your original mortgage and your home equity loan into a new loan. You will save $200 a month in mortgage payments, but you have to pay $3200 in closing costs and points. After 16 months your savings will equal your upfront expenses; this is your ‘break-even point.’ The longer you stay in your home thereafter the greater your savings will be. Make sure you have the time to stay put before you consider a new loan.

Loan Terms

You also have to consider how long you have left on each of your existing home mortgages. When you refinance you will be restarting a long loan term and your interest payments will be

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amortized all over again. The shorter your current loan terms are, the smaller the savings you will see from refinancing.

Be sure to discuss the options with your financial advisor or trusted mortgage professional. There are other factors that might play into your situation. A new refinance loan may be the perfect option to help you save some money!

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