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Timing Your Refinance is Important

When should I refinance my mortgage loan? Most lenders and a lot of mortgage literature will answer this question by telling you to calculate how long it would take for the refinance rate savings to equal the upfront costs of refinancing. So, for example, you could refinance right now and start saving $45 a month on your mortgage payments, but you would have to pay $1600 in closing costs. It would take almost 36 months, or three years before your would realize the savings of that lower rate refinance loan. If you plan to stay in your home three years or longer, most people would tell you that you should indeed refinance your mortgage loan.

New research suggests however, that this may be too simple of a strategy. In a paper titled “When Should Borrowers Refinance Their Mortgage?” a group from FleetBoston Financial, and Brown and Harvard Universities conclude that “all pre-existing research on refinancing has emphasized procrastination – i.e. late, slow, or non-existent refinancing – as the principal error that mortgage holders make,” yet the biggest mistake may actually be refinancing too early, and not waiting for an even lower interest rate.

The study suggests that homeowners consider the market trends and think about waiting if interest rates are likely to continue dropping. You may save money by refinancing now, the authors say, but perhaps you could save twice as much money by waiting a few months before refinancing. Let’s say your original mortgage carries a 7.5 percent interest rate. On a $200,000 30-year fixed rate loan, your monthly payment equal $1,398.43. If you were to refinance after three years, you would have already paid off $6,000 of your loan. Say you refinance at an interest rate of 6.75 percent, your new monthly payment would be $1,258.28, a monthly savings of roughly $140. If you were to wait a month and rates fell to 6.5 percent, you could refinance and pay $1,226.21 monthly for a $170 a month savings. That amount of savings will make the pricey upfront fees and closing costs more worthwhile. Plus over the life of the loan you will over $10,000 in interest over the refinance loan with 6.75 percent interest.

And indeed the eventual conclusion of the paper is that, all things considered, the best time to refinance your mortgage loan is when interest rates have fallen 1 percent to 2 percent lower than your original rate. If you are planning to move within the next decade or so, you may have to look for an even lower interest rate in order to realize the most savings.

Basically, the point is that you should not jump into a refinance loan as soon as it would save you money. The point is to wait for rates to fall low enough for you to save lots of money! Of course, if you are refinancing to get out of already unaffordable payments or a soon-to-reset interest rate, you may not have the luxury of waiting for those optimal savings. In that case, you will have to settle for a refinance loan that allows you to simply hold on to your home.