Essential Refinance Mortgage Loan Vocabulary

Refinancing is the process of taking out a new home loan to pay off your existing mortgage. If you are looking into a refinance mortgage loan, you will run into a lot of mortgage jargon as you search for the right financing. You can help ease the process by acquainting yourself with some of the most commonly home refinance keywords. Take a look at the following terms and definitions:

Annual Percentage Rate (APR) – This is an interest rate that indicates the yearly cost of a refinance loan. It includes the costs of not only interest, but also closing costs, points, and mortgage insurance charges. Comparing different offers based on the APR is a better way of determining which loan is less expensive than using just the advertised interest rate. The APR takes into account all the total annual costs.

Break-Even Point - This is the amount of time it will take to “break even” between your closing costs and the savings on your new loan. It is a bad idea to refinance if you do not plan to stay in your home long enough to reach that point. The break even point is calculated by dividing your total closing costs by the amount of money you will save on your mortgage payment each month because of the refinance loan. For example, you get a refinance loan that will save you $150 a month, but you have to pay $3000 in closing costs. Your break-even point will be 20 months. That means at 20 months your upfront expenses equal your savings. Staying longer than 20 months will mean that the refinance is actually profitable to you.

Cash-out Refinance – Getting a cash-out refinance means creating a new home loan that is large enough to both completely pay off your existing loan and allow you to pull some cash out to use for other financial ventures. Many people take advantage of these types of refinance mortgages in order to get some money for home repairs or renovations, consolidate debt, or pay for college tuition or other large expenses.

Closing Costs – If you are refinancing, that means you have already gone through the mortgage process before and have experience with closing costs. These are the fees you are required to pay at the close of the loan. They include points, appraisal fees, title search charges, insurance premiums, taxes, and lawyer’s fees, among others. You will find that closing costs generally range from 3% to 6% of the mortgage refinance loan. Closing costs are very important to a refinance loan because they may determine whether or not the interest savings are worth the switch. You have to find the break-even point to see how long you have to stay in your home to make the refinance worthwhile.

Points - Points are a fee you pay to your lender in order to “buy-down” or decrease the interest rate on the refinance loan. One point is equal to 1% of the home loan total. Some lenders will require that you pay points while others do not. You must decide whether paying extra upfront costs will mean real savings in the long run. Be aware that paying more points will increase

your break-even point.
Pre-payment Penalty – Some loans include a penalty for pre-paying your loan balance, or repaying part or all of your home loan balance before the end of the original term. Lenders charge this fee so that they will be compensated for losing the interest payments you would have made on a full term loan. Before you refinance, check to see if your current home mortgage has a prepayment penalty to determine if the savings will be worthwhile. You should also find out if the new refinance loan you are applying for has a pre-payment penalty. That may determine how soon you will be able to refinance again in the future.

Hopefully, this crash course in refinance terms will prove useful as you shop around and compare refinance packages. Be sure to talk with your trusted financial advisor or mortgage broker about any terms you do not understand and to determine whether a refinance mortgage loan is right for you.