

CAN REFINANCING YOUR HOME SAVE YOU MONEY?

Over the past several months we have been bombarded with news regarding the Federal Reserve Board's repeated decisions to lower the Federal Funds and Discount interest rates. The impact on short term rates is immediate. Witness that searching for a money market rate approaching 5% has become increasingly difficult. What about mortgages?

Mortgage rates have floated less dramatically downward because they are more dependent on *long*-term rates. Enthusiastic consumers searching for cost savings must calculate carefully to determine whether re-financing their mortgage will actually save money.

Joe McMonagle, Senior Mortgage Development Officer for Sovereign Bank, offers this formula: divide your anticipated closing costs by your monthly payment savings. For instance, suppose a homeowner would have to pay \$2,000 in closing costs - for a \$200/month savings. It would take 10 months at the new lower payment to *breakeven* with the cost for purchasing the loan. The homeowner could actually start saving money in month 11 of owning his re-financed mortgage. (This assumes, of course, no points accompany the loan.)

Generally speaking, McMonagle advises that a rate drop needs to be *more than* $\frac{1}{4}$ or $\frac{3}{8}\%$ to be worth refinancing. He reported that our post subprime lending climate demands higher consumer credit scores, demonstration of adequate income, and equity in the home before a loan is likely to be approved. Lenders have become very sensitive to risk.

Mortgage rates continue to test historical lows during this first decade of the 21st century. As this column was being written, Sovereign's rate for a 15-year fixed mortgage was just 4.99%, and for a 30-year fixed was 5 $\frac{1}{2}\%$. McMonagle indicated that many adjustable rate mortgages are now priced with little savings compared to fixed rate options, thus reducing the potential benefits. Watch out for Jumbo mortgages! If you're looking for a mortgage over \$417,000, Jumbo rates range from 6 $\frac{1}{2}\%$ for a 15-year fixed to about 7% for a 30-year fixed.

What if you are considering a "cash-out" as part of your package? Sharon Pierson, CPA, in Exton, cautions that a portion of your interest may *not* be an itemized deduction for federal income tax purposes. In addition, if your new loan is *larger* than your prior principal balance, Pierson reminds us that the interest paid on the increased loan value could be an 'add back' for AMT (Alternative Minimum Tax). It depends on how you *use* the additional funds.

A cash-out directed toward home improvements is still fully deductible if the principal balance of the new loan is \$1 million or less (for married taxpayers filing a joint return.) A cash-out utilized for other purposes - college tuition or clearing up credit card debt, for instance – could trigger AMT liability. Pierson indicated other nuances and thresholds apply with respect to home equity loans, and for “uses” such as funding a business. Smart shopper homeowners who purchased their existing mortgage relatively recently may be anticipating discounts with respect to settlement fees. Unfortunately, due to diminishing home values, lenders are likely to require a new appraisal. That means another fee.

Title Insurance costs, however, may be less the second time around. Rates are set by Pennsylvania State Law using a three-tier structure: Basic, Re-issue, and Substitute. Basic rates are applied if a title was not issued within the past ten years. Re-issue rates are 10 – 20% less than Basic rates, and are calculated on the *mortgage amount only* – not the value of the home. Substitute rates apply for properties originally insured within the last three years.

Some of the best ways to prepare yourself and your family for money-saving loan rates occur prior to applying. Imprint the habits of (1) saving a 20% down-payment - or increasing your home equity to at least 20% of your home’s value, (2) maintaining a high credit score – or cleaning it up and waiting 12 months before shopping for a loan, and finally, (3) building your sustainable income so lenders consider you a good risk. Contact your financial professional to confirm that your plan of action suits your unique situation. Fulfilling the *American Dream* may cost you less!

Joslyn G. Ewart is an educator, financial analyst, and business owner. Her firm, Entrust Financial, LLC®, is the financial partner of a select group of successful individuals and families in the Delaware Valley. Her business column appears on a regular basis in Main Line Life. E-mail: joslyn@entrustfinancial.com.