30 years or less?

Perhaps trimming monthly payments is not your prime motive. You're more interested in getting the house paid for before you retire or send your kids to college. Then a 15- or 20-year mortgage may be the best option.

If your object is to take advantage of reduced interest rates, and not to take some money out of the transaction as you refinance, be careful to compare apples to apples. For example, if you're in the eighth year of a 30-year mortgage, your current loan has 22 years left. Refinancing into a new, lower rate, 30-year mortgage at this point might not save money over time.

Ask your lender to help you calculate the cost of your mortgage's remaining 22 years at the new, lower interest rate. Or use a mortgage calculator at *creditunion.coop*. Then you might decide a new 15-year mortgage is a better choice than taking another 30-year mortgage: It lets you take advantage of lower interest rates and build up savings (in the form of equity in the asset, your house) instead of just spending the difference in mortgage payments.

With a shorter-term mortgage, your monthly payment may not go down, or may rise somewhat, compared with what you're paying for your current 30-year mortgage. But you'll save thousands of dollars over the loan's lifetime. For example, for a 30-year mortgage of $110,000 at 6%, you'll pay total interest of about $127,422 (monthly payment $660), compared with about $57,083 total interest (monthly payment $928) for a 15-year mortgage at the same interest rate. But you'd likely save even more, because the 15-year mortgage should cost less, perhaps 5.5% in this example. Total interest would be $51,783 and monthly payment would be about $899.

Some consumers say, sure, you save total interest with a shorter-term mortgage, but you also lose several years' worth of income tax deductions for that interest. That's perverse reasoning. At the 28% tax rate, you get to keep 72 cents of each interest dollar you save by refinancing. You save many thousands of dollars (more than $50,000 for the example in the previous paragraph) over the lifetime of the mortgage.

Remember, too, that with a shorter-term mortgage, you build equity faster. If you decide in the future to take a home equity loan, you'll have more equity to draw on. And the interest on a home equity loan usually is tax deductible.

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Mortgage Refinancing: You Could Save a Bundle

With today's interest rate environment, many homeowners wonder: Is it time to refinance my mortgage?

No pat formulas exist to help you answer that question. Gone is the old "two-two-two rule"—that you should swap mortgages only if you've been in your house more than two years, expect to stay at least two more years, and the new interest rate is two percentage points lower than your current rate.

In today's refinancing scene, there's no such rule. One mortgage lender says, "You refinance when it feels right—when there's enough economic necessity or enough perceived value in the mind of the consumer." But usually you need 20% equity in your house to be able to refinance.

Besides the "when is the right time" question, you face a host of others: Should I opt for a 15- or 20-year mortgage instead of a 30-year fixed mortgage? Or should I go with an adjustable-rate mortgage (ARM)? And what about the no-points/higher-rate loan vs. a loan with points but a lower interest rate?

Here's what to consider to sort your choices.

Act now or later?

No one knows where rates will go. Should you refinance now, or wait in hopes that rates may drop further? No one can tell you.

Say you trade your 8%, 30-year mortgage of $110,000 for a new one at 6%. Your monthly payment will drop from about $807 to $660, a savings of $147 a month. If you were to nab a 5.5% loan some months from now, your monthly payment would drop an additional $36, to $624.

But while you wait, hoping to get an even lower interest rate, you're losing savings of $147 a month. Is it worth saving the not-so-sure extra $36? For every month you delay, you'd have to own your house at least five extra months (beyond the time needed to recover refinancing costs) for the waiting game to pay off. Of course, you'll be out some money if rates climb rather than fall and you eventually refinance anyway.

Is it worth the gamble? Only you can answer, based on your economic situation and how long you plan to stay in the house.

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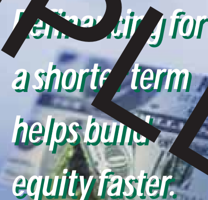
What about refinancing costs?

The savings come with a price, in the form of refinancing costs. Chief among these are points. A point is equal to 1% of the mortgage amount. For example, two points on a $110,000 mortgage would be $2,200.



When you refinance, you typically pay off the original mortgage and acquire a new one. Find out if your current mortgage has a prepayment penalty, and how much it will be.

Other refinancing costs include application fees, also called origination fees (for processing, appraisal, credit check, and title search), and closing costs. Most lenders will allow you to roll some, perhaps all, of your refinancing costs into your new loan. Say the points and other refinancing costs total 3% of the mortgage amount (the average ranges from 2% to 4%). For a $110,000 loan, that's $3,300. In the scenario described above, you reduced each monthly payment by $147. That means it would take about 23 months to recoup refinancing costs ($3,300 ÷ $147 = 22.4). If you plan to sell your house sooner than that, don't refinance.

You may be able to choose between a 5.5% loan with two points and a 6% loan with no points for a 30-year mortgage. Which way to go? The key is how long you expect to stay in the house. Opting for the no-points loan will save up-front money ($2,200 on a $110,000 mortgage). But your monthly payment will go up from about $624 to $660, about $36 a month. After five years, you'd save as much with the lower monthly payments as you would by choosing the no-points loan. If you plan to sell your house within five years, you're money ahead with the no-points loan.

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Fixed or adjustable?

If you plan to sell your house in a few years, consider refinancing with an ARM rather than a fixed mortgage. A typical ARM has a two-percentage point annual cap and a six-percentage point lifetime cap. That means if interest rates rise, your mortgage rate may increase two percentage points a year, to a maximum of six points.

With an ARM of, say, 4%, you'd be assured of low payments the first year. On a $110,000 mortgage, your payments would be about $525 a month. Even if the rate increases two percentage points in the second year, you'd still be getting a good deal at 6%, with your monthly payment up about $135. After that, it gets a little dicier. But, if you still plan to sell your house within a few years, you may be better off with an ARM. ▶

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