

## Refinancing Your Mortgage

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Most people consider refinancing their home mortgage to take advantage of lower interest rates and reduce their monthly mortgage payment. Refinancing a mortgage means paying off your old mortgage and signing a contract for a new loan. Whether to refinance your mortgage is a difficult question to answer, and should be based on the following considerations:

### What Is the Difference between the Rate of Interest You Are Paying Now and the Current Mortgage Interest Rates?

A general guideline is to consider refinancing a mortgage when the current mortgage interest rates are at least two or more percentage points below what you are paying now.

The following chart shows what you would pay by refinancing your mortgage at certain interest rates. Assume

you started out with a 10 percent, 30-year fixed-rate mortgage for \$120,000 with \$1,053.09 monthly payment.

### How Will a Lower Mortgage Interest Rate Affect Your Income Tax Deductions and/or Tax Obligations?

A lower mortgage interest rate means you pay less total interest per year, and thus, there is less interest available to deduct from your income for tax purposes. Your income-tax liability is likely to increase, and the savings in mortgage interest must offset this. The total impact of a reduced mortgage interest rate depends on factors such as your income, tax bracket, and other deductions. (See the Refinancing Your Mortgage Work Sheet at the end of this publication.)

Some refinancing costs may be tax deductible in the year you refinance. However, discount points usually must be deducted over the life of the mortgage, even if paid up-front. Check with your local IRS office.

| Present 30-Year Mortgage Rate | Monthly Payment (\$) | Monthly Difference (\$) | Yearly Difference (\$) | Total Interest Paid after 30 Years |
|-------------------------------|----------------------|-------------------------|------------------------|------------------------------------|
| 5.26                          | 663.39               | 389.70                  | 4676.40                | \$118,818.56                       |
| 5.43                          | 676.09               | 377.00                  | 4524.00                | \$123,388.69                       |
| 6.00                          | 719.46               | 333.63                  | 4003.56                | \$139,006.23                       |
| 6.26                          | 739.64               | 313.45                  | 3761.40                | \$146,271.75                       |
| 6.43                          | 752.97               | 300.12                  | 3601.44                | \$151,064.63                       |
| 7.00                          | 798.36               | 254.73                  | 3056.76                | \$167,413.25                       |
| 7.26                          | 819.43               | 233.66                  | 2803.92                | \$174,989.18                       |
| 7.43                          | 833.31               | 219.78                  | 2637.36                | \$179,995.61                       |
| 8.00                          | 880.52               | 172.57                  | 2070.84                | \$196,983.46                       |
| 10.00                         | 1,053.09             | 0.00                    | 0.00                   | \$259,103.10                       |

Source: computer using the mortgage calculator at bloomberg.com



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Produced by Agriculture and Extension Communications, Virginia Tech

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## What Are Discount Points, and How Can They Affect the Cost of Your Mortgage?

Each discount point is equal to 1 percent of the loan amount. Charging points is a method lenders use to adjust interest rates, so the lower the interest rate, the more points you may have to pay. The higher the interest rate, the fewer points. Points and interest rates figured together determine the annual percentage rate (APR). Lenders are required by law to provide you with the APR, and it is a good way to compare combinations of points and interest rates to determine the best deal. But remember, there are other costs, such as closing costs, associated with refinancing that must also be considered.

## How Long Do You Plan To Live in Your Current Home?

If you are not sure how long you plan to live in your current home, or feel that you will probably live there three years or less, you may not have enough time to recover the costs of refinancing. For example, if refinancing your home will save you \$50 per month on your mortgage, but the closing costs come to \$4,000, it will take 80 months, or over six years, to recover the cost of refinancing. (See the Refinancing Your Mortgage Work Sheet.)

## Will You Stay with Your Current Lender or Change?

It might be possible to renegotiate your mortgage at a lower interest rate with your current lender, usually for a set fee. Renegotiating a mortgage is technically not refinancing, but it is an amendment to your existing mortgage. Although the interest rate may not be as low as the current refinancing rate, renegotiating can save you money because you pay no closing costs. If you can't renegotiate with your current lender, shop around and ask for a list of charges to compare interest rates and closing costs. Closing costs vary considerably, depending on factors such as the current mortgage market, lender policies, type of loan, and age of existing loan. The total charges for refinancing usually cost between 3 percent and 6 percent of the total amount of the mortgage.

## Should You Refinance a Larger Amount than Your Current Mortgage?

If the value of your home has increased, you may want to look at the possibility of refinancing more than the value of your current mortgage. Since mortgage interest remains a deductible expense on federal income taxes, there are guidelines on how the equity can be used to take advantage of the full interest deduction. If the amount of the new mortgage is equal to or below the original price you paid for the house, the full interest deduction will apply. You can also use the equity for home improvements or other allowable expenses such as education or medical expenses

| USUAL CLOSING COSTS        | AVERAGE CHARGES               |
|----------------------------|-------------------------------|
| Loan origination fee       | usually 1% of the loan amount |
| Discount points            | 0-1.5% of loan amount         |
| Application fee            | 0-\$200                       |
| Appraisal fee              | \$300-\$400                   |
| Title examination          | \$250                         |
| Title insurance for lender | \$3.50/\$1000 of loan         |
| Land survey                | \$250                         |
| Credit report              | \$15-\$60                     |
| Documentation/preparation  | \$185                         |
| Legal fees                 | \$99-\$250                    |

(The above average charges are according to Clay Greenway, Mortgage Capital Investors Loan Officer)

or to cover closing costs of the refinance. Again, consult your local IRS office because there are limitations on how much of the total costs are allowable.

Appraisals are required to determine the value of the home and the loan amount. In some cases, homeowners who look at refinancing find that their homes have increased or decreased in value over time. If the value has decreased, refinancing may not be an option since most lenders will only refinance 80 percent of the home's current value, and the amount of the original mortgage may exceed this amount. If a lender does refinance more than 80 percent of the home's current value, the lender will require mortgage insurance, which will increase the closing costs and the monthly mortgage payment.

*It is important to remember that your home is at risk if you default, no matter what expenses were paid for with the equity.*

## Should You Contract for a Shorter Time Period on Your Mortgage?

Another option you might consider is to refinance your mortgage for a shorter time period. Although your mortgage payments will be somewhat higher, you will pay less interest over the life of the loan, and build equity more quickly.

**For More Information**

Federal Trade Commission Headquarters  
 CRC- 240  
 Washington, DC 20580  
 (202) 326-2222  
 www.ftc.gov/bcp/conline/edcams/credit/coninfo\_mortgage.  
 htm

Mortgage Bankers Association of America  
 1125 Fifteenth Street, N.W.  
 Washington, DC 20005  
 www.mbaa.org/

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**Refinancing Your Mortgage  
 Work Sheet**

*Original Source: Kiplinger's Personal Finance Magazine*

The example is for refinancing a \$100,000, 30-year fixed-rate mortgage at 10% with the same mortgage at 6%. (25% tax rate)

**THE COST OF REFINANCING:**

|                                  | <i>Example</i>  | <i>Your Loan</i> |
|----------------------------------|-----------------|------------------|
| Loan origination fee             | \$ 1,000        | \$ _____         |
| Discount points                  | 0               | _____            |
| Application fee *                | 200             | _____            |
| Appraisal fee                    | 400             | _____            |
| Title examination                | 175             | _____            |
| Title insurance for lender       | 350             | _____            |
| Land survey                      | 250             | _____            |
| Credit report                    | 60              | _____            |
| Documentation/preparation        | 185             | _____            |
| Legal fees                       | 150             | _____            |
| <b>TOTAL COST OF REFINANCING</b> | <b>\$ 2,770</b> | <b>\$ _____</b>  |

**THE PAYBACK:**

|  |               |              |
|--|---------------|--------------|
| Current monthly mortgage payment (principal & interest)                        | \$ 878.00     | _____        |
| Subtract new monthly mortgage payment (principal & interest)                   | - 599.55      | _____        |
| Pretax savings per month   | 278.45        | _____        |
| Multiply your tax rate by your pretax savings & subtract result                | - 40.00 (25%) | _____ (____) |
| Your after-tax savings per month   | 208.83        | _____        |
| Divide monthly savings (\$208.83) into the total cost of refinancing (\$2,770) |               |              |
| <b>NUMBER OF MONTHS TO BREAK EVEN</b>  | <b>13.26</b>  | _____        |

\* Application fees may not be refundable if you are not approved for refinancing. Check with your lender.