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Money Matters | Thinking of refinancing? Here's what to consider

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You have probably heard or seen recent advertisements about historically low interest rates and what a great opportunity you have to refinance your home mortgage.

Maybe you have considered it, or perhaps you even did refinance at some point in the past few years. The reality is that no matter when you took out your mortgage, you should at least consider a mortgage refinance given how low rates have dropped. Currently a 30-year mortgage was running at 3.5% with no points paid, and a 15-year mortgage was at 2.75%. If your mortgage is 0.75% higher than these rates, it likely makes sense to at least consider a refinance. Below is a summary of the key items to consider when evaluating your options.

Why refinance?

There are a few primary reasons to refinance. The most common is to lower your interest rate, which reduces your interest costs and your monthly payment. Other reasons would be to change the length of your loan term, or to cash out some of your equity for a home remodel or another purpose.

• Closing Costs. These are simply the transaction costs required to complete the refinance. The mortgage company you choose needs to get compensated, and there are various services that need to be performed in order to complete the refinance. These costs must be factored in to the decision. It is best to pay these costs with cash outside of the loan amount; however it is possible to "roll" the costs in to the new mortgage amount. It is important to note that closing costs are different than pre-paid costs. If you escrow your property taxes and homeowners insurance, your new lender will require you to put in additional cash to prefund the escrow account. This may feel like an additional "cost", but these are non-mortgage expenses that you would have had to pay no matter if you refinanced or not. In fact, you will likely get an escrow refund a few weeks after your existing mortgage is paid off with the refinance.

• Appraised Value. Given the recent decrease in home values and the tough real estate market, the appraised value of the home is a critical component of a mortgage refinance. In order to get the best deal on a mortgage, the mortgage amount needs to be 80% or less of the home's appraised value. If your home has decreased in value since you purchased it, your mortgage amount may be higher than 80% of the current value. This may make a refinance less attractive, or more difficult to get approved. The federal government has tried to provide some relief with a recent expansion of the Home Affordable Refinance Program (HARP). If you find yourself with a high loan-to-value, I suggest talking to your mortgage professional about your eligibility for the HARP opportunity.

• Holding Period. When evaluating a refinance, an important consideration is how long you plan to stay in the home. Since there are costs to complete a refinance, you need a certain amount of time to recoup those costs with interest savings that comes with the refinance. If you are planning to sell your home in the next year or two, there may not be enough time to recoup your closing costs through interest savings. Your mortgage professional should be able to help you evaluate how long you need to stay in the home in order to "break even", or recoup your closing costs.

• Term. The term, or number of payments, you select for your refinance loan will impact your monthly payment. Some borrowers are using the low rates as an opportunity to shorten the term on the mortgage and keeping their payment roughly the same as you are making today. This will allow you to pay your mortgage off faster. You will want to decide whether you want to keep the same payment and pay the loan off faster, or reset your term and decrease the monthly payment.

If you are a homeowner with a mortgage, you would be wise to consider a refinance at today's low rates. You could reduce your payment and interest costs, or shorten the length of time that you will be paying on your loan.

The Money Matters column is written by members of the Financial Planning Association of Greater Kansas City. This week: Lucas Bucl (lbucl@makinglifecount.com), a Certified Financial Planner with KHC Wealth Management, Overland Park.
