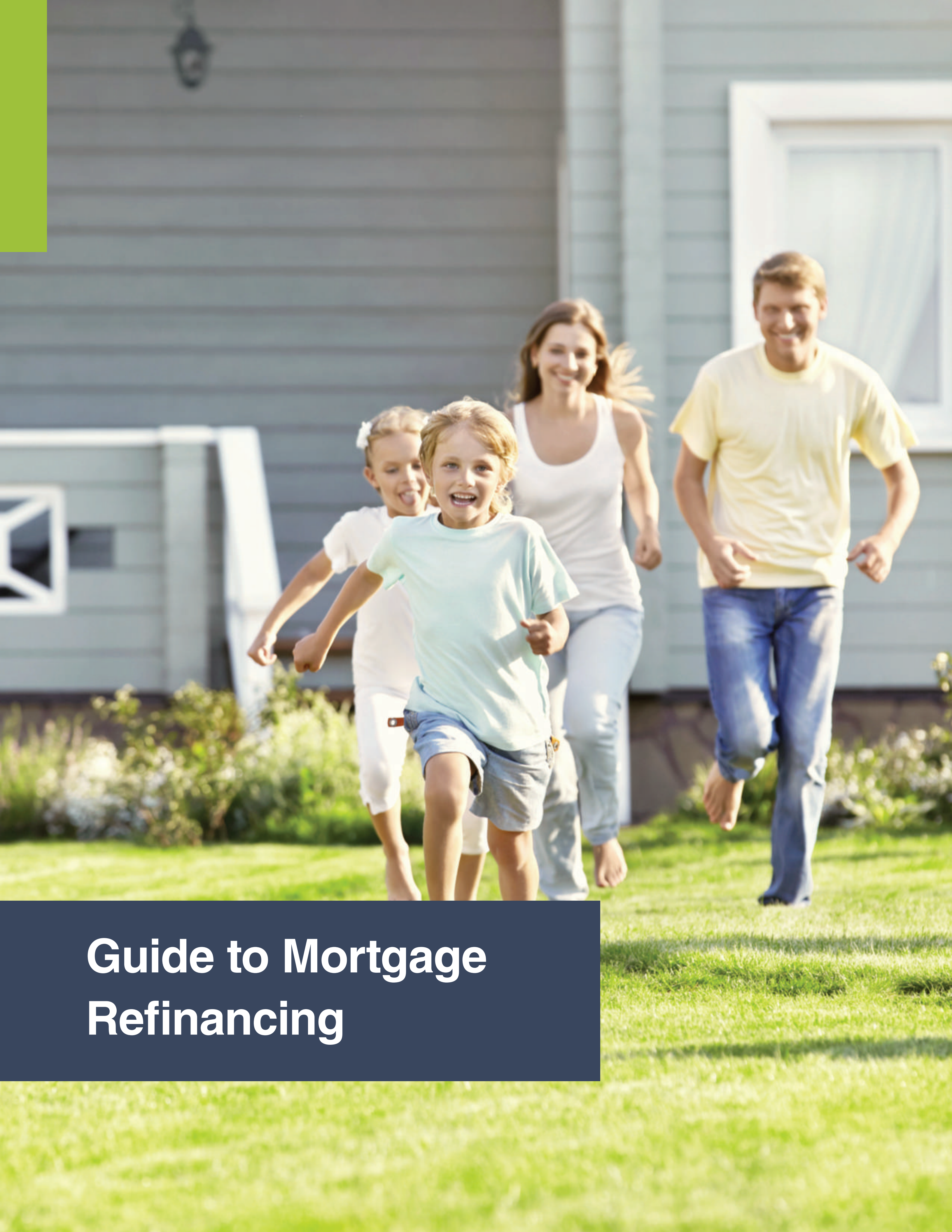
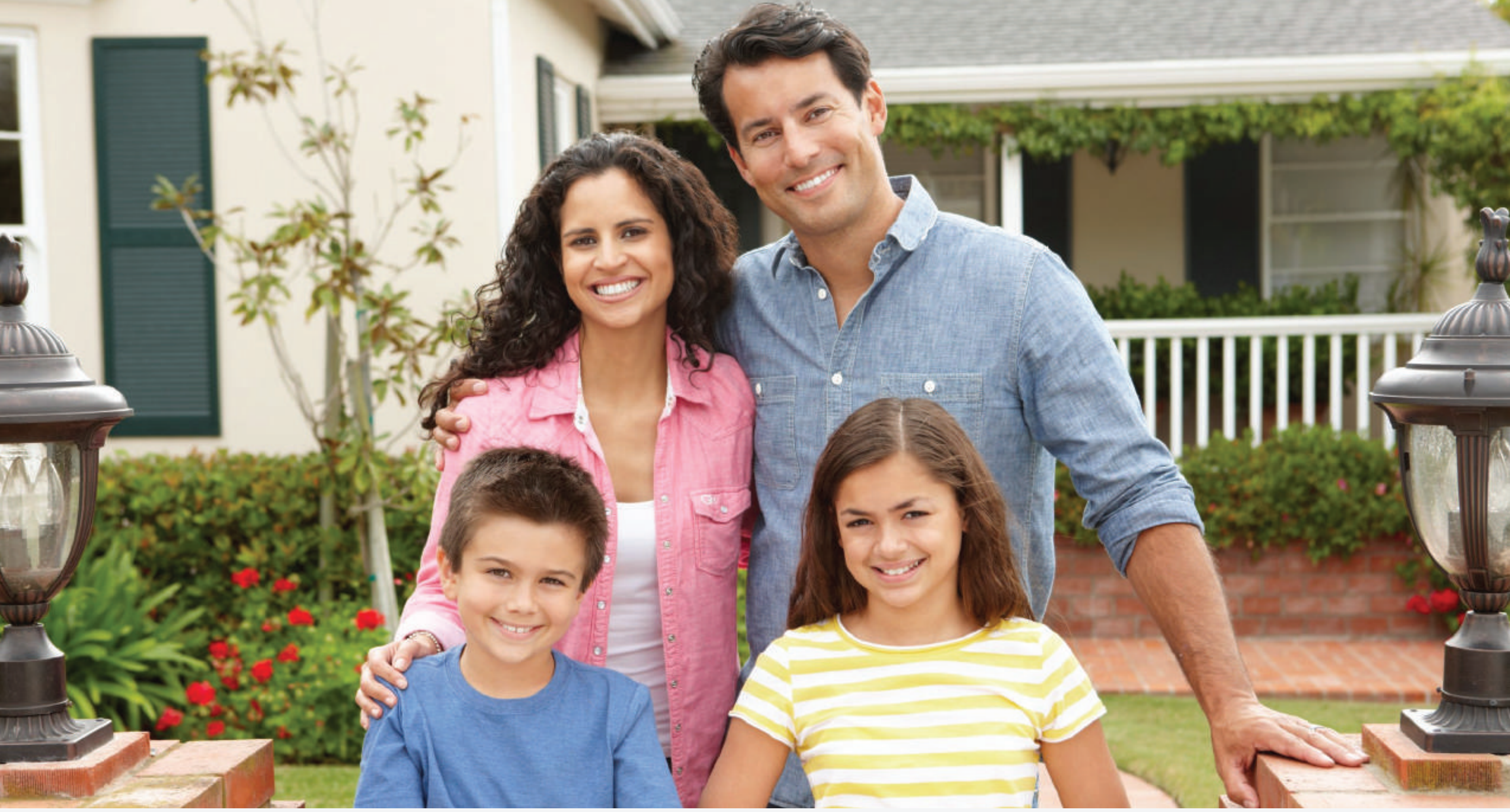


Guide to Mortgage Refinancing



Refinancing a home mortgage can lower your payments and total mortgage cost or allow you to use the equity in your home for other financial purposes. As with other mortgages, it is important to consider the qualification requirements as well as the purpose of the refinance.

Getting Pre-Approved for Mortgage Refinance

Refinancing your mortgage involves very similar steps and qualifying requirements as those used to apply for a new home mortgage.

Qualification Factors

Credit Score and History

Your credit score and history are still one of the most significant factors impacting your ability to qualify for a mortgage refinance. Even if you qualify off of other factors, a poor credit score and history can increase your interest rate significantly.

Lenders want to see that you have been able to manage and pay all of your current debt payments each month without being late or missing a payment. Having these marks on your credit history may not rule you completely out for a mortgage, but do they do factor heavily in the lender's decision.

Income

Your credit score and history are useless if you don't have enough income to pay your mortgage or other debts.Even if your income has declined since closing on your current mortgage, you may still qualify for a refinance if the new mortgage payment is low enough to offset your decline in income.

The amount of your monthly income compared to the total amount of your monthly debts is referred to as your debt-to-income ratio.

Debt and Debt-to-Income Ratio

Each lender has guidelines as to how much debt an individual can comfortably carry given their income. Some lenders want your total debt payments to be less than 30% of your income while others will approve loans up to a 38% debt-to-income ratio. Ask your potential lenders what their guidelines are before applying for your refinance loan.

If you are considering a mortgage refinance it is wise to pay off as many of your debts as possible to keep your debt-to-income within these guidelines.

Assets

Lenders like to work with borrowers that have assets that can be used as collateral against a loan. In the unfortunate situation the borrower cannot repay the loan those assets can be seized and sold in order to make the lender whole.

Having a solid base of assets also shows lenders that you know how to grow your net worth, are responsible with your income, and overall are running your financial life well.

Appraised Value and Loan-to-Value

Your home's worth is a critical piece of data for a lender. If your home's value has dropped significantly below what you owe on it, the lender won't be able to give you a refinance loan regardless of your other qualifying factors. A borrower in this situation would need to pay off the difference between the original mortgage and the refinance amount first. In short, a lender cannot let you borrow more money than what the property is worth.

On the other hand, borrowers in homes that have gone up in value are a welcome customer to lenders. The increased equity you hold is an added safety net for both the borrower and the lender. Most lenders set a maximum loan-to-value ratio target of 80%. (Some specialty programs such as FHA loans allow for 100% loan-to-value.)

If you want to refinance a $200,000 home the maximum loan you could have is $160,000 with the rest being equity from your original down payment and regular monthly payments.

If that same property goes up in value to $250,000 due to a hot real estate market, and you still only owe $160,000, your loan-to-value has dropped to 64%. This very healthy number leads to many lenders welcoming you with open arms, assuming your other qualifying factors are solid.

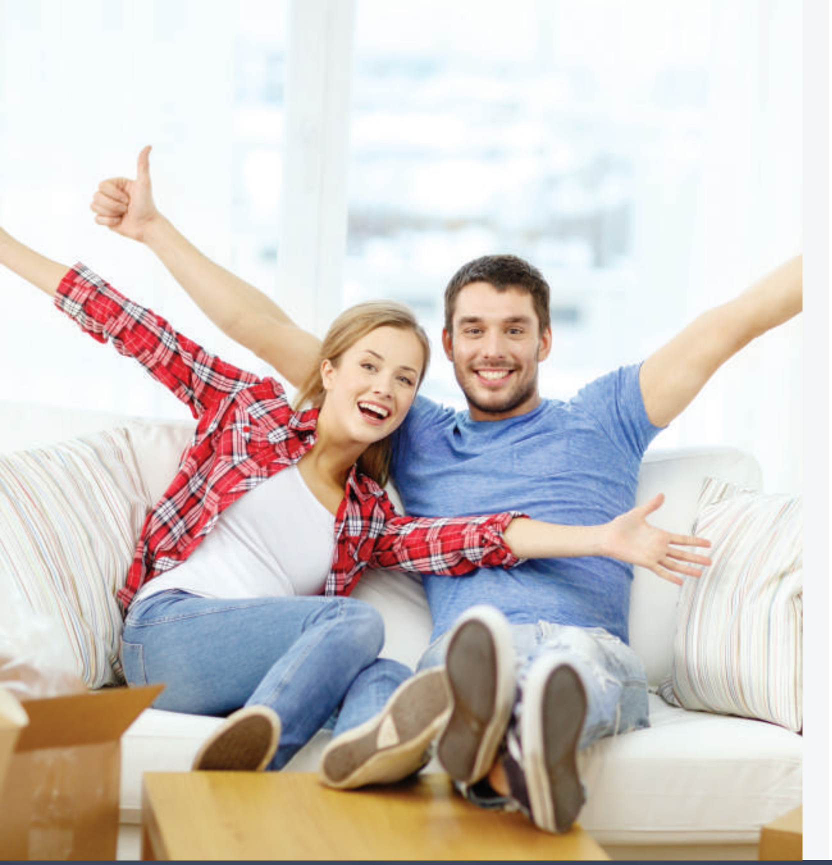
Types of Mortgages

There are several types of mortgages available to refinance your loan into.

Fixed-Rate Mortgage

One of the most common refinance mortgages is the fixed-rate mortgage. Perhaps you had an interest-only loan or an Adjustable-Rate Mortgage with an interest rate that has gone up. Or maybe you purchased your home originally with a fixed-rate loan, but at the time rates were higher than they are today.

No matter the reason for the refinance, a fixed-rate mortgage is an excellent choice to refinance into. Your interest rate is set for the duration of the mortgage. Your payments to the lender are fixed and never change. This allows for consistent budgeting and as your income grows over time through inflation your payment feel smaller.



Adjustable-Rate Mortgage or ARM

Adjustable-Rate Mortgages (commonly referred to as ARMs) are another common refinance option. With an ARM loan your interest rate is set for a specific period of time. After that first term the rate adjusts based on conditions in the interest rate market on a periodic basis. Refinancing into an ARM can help you drop your current rate to something in line with today's low interest rate environment.

FHA Loan

The Federal Housing Administration has a specific home mortgage loan program that allows qualified borrowers to bring a smaller down payment to the closing table. The FHA's purpose is to increase home ownership in the United States. Instead of lending directly to borrowers, they provide a guarantee on a portion of the loan through insurance payments the borrower makes to the FHA.

For example, a borrower could bring as little as 3.5% of the loan value to the closing table at a refinance. That's a loan-to-value of 96.5%, well above the industry's standard of 80% LTV.

This comes at a cost, namely a 1.75% upfront insurance premium as well as an annual premium that is based on both the term of the new loan and the amount of your down payment.

Here's a list of the annual premium costs of a loan through the FHA:

- 0.45% annual premium for a 15-year loan with 90% LTV or less
- 0.70% annual premium for a 15-year loan with greater than 90% LTV
- 0.80% annual premium for a 30-year loan with a 90% LTV or less
- 0.85% annual premium for a 30-year loan with greater than 90% LTV

VA Loan

The Veteran's Administration runs a loan program as well. As with the Federal Housing Authority, the VA does not lend actual dollars to borrowers. Instead they allow qualified borrowers (primarily Veterans of the United States' military) to have a portion of their loan insured by the VA. This insurance applies to refinances as well.

Reasons to Refinance Your Mortgage

There are many reasons a borrower looks to refinance their home mortgage.

Divorce Settlement

Another frequent reason to refinance is to settle a divorce. Either the home must be sold or the mortgage refinanced, usually to a longer term length, to allow the spouse that retains ownership of the home to be able to afford the monthly payments.

Lower Monthly Payment or Reduce Mortgage Term Length

A common reason to refinance your home mortgage is to reduce the amount of money you end up paying in total on the loan. This can be from reduced monthly payments, reduced mortgage length, or ideally both.

Interest rates were in the 4%-5% range just a few years ago. Dropping your rate through a refinance to 3.5% could save you hundreds of dollars per month on each mortgage payment. You could use those dollars to continue paying down the loan, to build up savings in another area of your life, or simply use them to pay your monthly expenses.

Alternatively, refinancing to a shorter mortgage term allows you to save money due to paying off your loan faster. Dropping the rate here helps too because a lower interest rate combined with a shorter mortgage term could leave you with a payment very close to the one you were previously paying. However, your new payment has a significantly higher portion of the payment going to the loan principal instead of interest to the lender.

Rate & Term Refinance

Lowering your payment, interest rate, or mortgage term length is always a good idea. Here are two key reasons a borrower would look to do just that.

Cash-Out Refinance

Home equity is a large source of potential cash that can be tapped by owners when they see fit. Here are three common uses of a cash-out refinance. These loans are seen as safer alternatives to a home equity loan or home equity line of credit because the interest rate is fixed with a set payment and term.

Cash for Home Improvement

Want to install a pool, add on to the back, or remodel your master bath? You can refinance your home for more than what you owe (while still staying below an 80% loan-to-value) to extract some of your equity as cash. That cash is then redeployed for whatever home improvement project you are taking on.

Pay Off Debt

As noted, interest rates are near historic lows. Other forms of debt such as car loans, credit cards, and student loans carry higher interest rates. In some situations it is mathematically better to refinance your home at a rate that is lower than your other debts, take some equity out in cash, and pay off your higher rate debts. Your home mortgage payment will be higher than in the past, but when looking at your overall financial picture you should be paying less each month in payments.

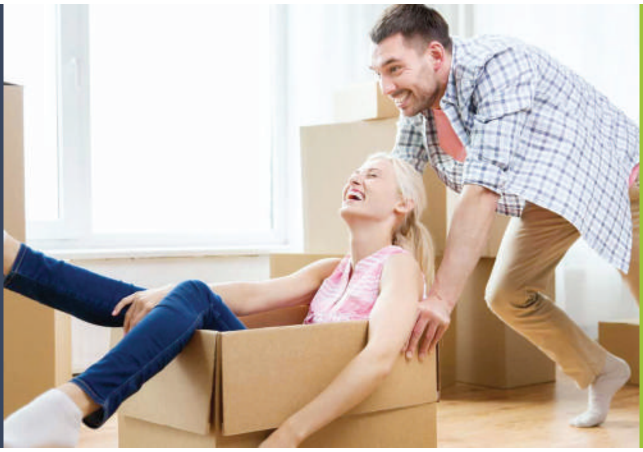
This use of a cash-out refinance only works if you don't go back into debt with those other higher-rate forms of debt. For example, paying off $20,000 in credit card debt at 20% is a great thing, but not if in a year you are back at $20,000 in debt on your credit cards. In that scenario you're now double in debt – a higher mortgage loan amount and credit cards.

Cash for Big-Ticket Purchases

Dreaming of owning a boat, building out the man cave, or taking the family on an unbelievable 4-week vacation to Europe? Your home equity can be tapped for these purposes, too. Essentially whatever you want to use that equity for becomes an option as long as you qualify for the refinance.

Home Equity Loans & Home Equity Lines of Credit (HELOC)

If you don't want to completely remove the equity in your home for a cash-out refinance you have a different set of options: you can take a loan against that equity. The two options available are a Home Equity Loan and a Home Equity Line of Credit (HELOC).

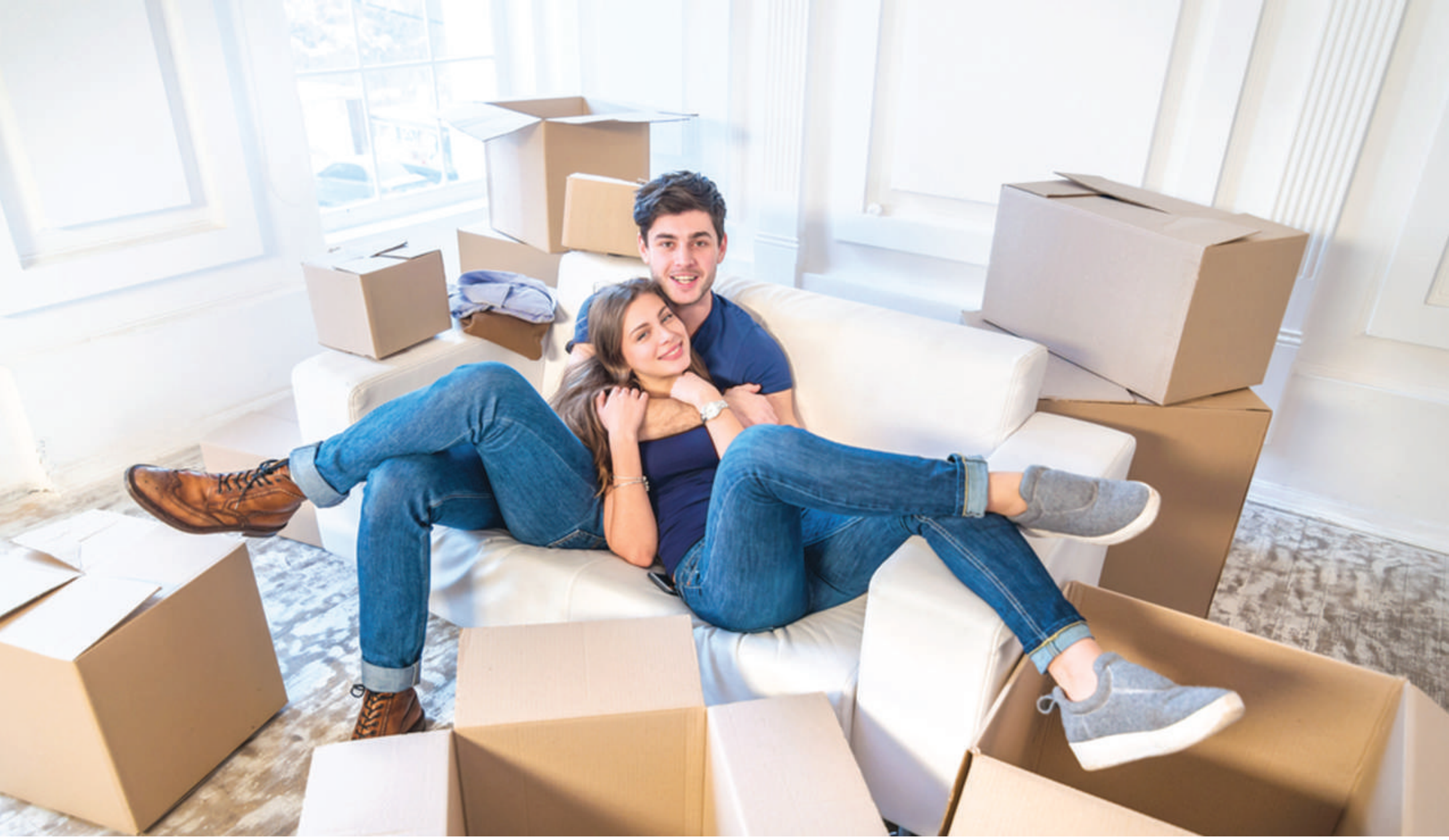


Difference Between Home Equity Loan and HELOC

The difference between the two is simple. With a Home Equity Loan you are accepting a loan for a specific amount of money based on the equity in your home. Once the loan funds are dispersed to you, monthly payments become due immediately. These loans are sometimes referred to as second mortgages.

A HELOC is a line of credit which is similar to having a credit card. The lender agrees to let you borrow against a certain amount of equity in your home, but you don't have to take the funds out immediately. This is similar to a credit card company that might give you a $10,000 line of credit, but you don't have to carry a balance. With a HELOC you could borrow the same $10,000 if you needed to, but aren't required to begin payments back to the lender until you withdraw funds from the HELOC. There is a set “draw” period, typically 10 years, where the borrower can withdraw funds when needed. At the end of the draw period the loan converts to a 15-year fixed or variable rate loan.

With some HELOCs your payments during the draw period are interest-only, so you're not paying down the balance of the line of credit. Some lenders offer a hybrid of the two where your loan payments made during the draw period apply toward the principal not just to cover the interest charges.



How to Choose Between a Home Equity Loan and HELOC

Determining which option is best for you depends on how soon you need the funds. A home equity loan is best used for definitive projects that you need to finance now such as putting in a pool or adding an addition to your home.

HELOCs can be used as a safety net or if you aren't sure if you will need to use the funds at all. They are also more common than Home Equity Loans.