

4 reasons not to refinance

Even with mortgage rates at historic lows, refinancing a home doesn't make sense for everyone. Here's how to figure out what you want, run the numbers and decide for yourself.

By [Liz Pulliam Weston](#)

Mortgage refinancings keep hitting record highs as interest rates dribble to generational lows. That doesn't mean everybody should join the party, however.

"Out of every 10 calls I get, probably three of them really shouldn't refinance," said mortgage broker J.J. Sims, owner of ABC Mortgage in Minneapolis and a member of the National Association of Mortgage Brokers' board of directors. "A lot of people get caught up in the hype of lower interest rates and don't really think it through."

The most obvious case of when refinancing doesn't make sense is when the homeowner won't live in the house long enough for the savings from a refinancing to outweigh the costs of getting a loan. (I'll tell you exactly how to figure that out below.)

Any of the following also can be red flags:

- **Have you been paying a long time on the loan you already have?** If you're 10 or 20 years into a 30-year mortgage, refinancing to another 30-year loan may only increase your costs in the long run.
- **Is your credit worse than the last time you got a mortgage?** If you've missed payments, run up big credit-card bills or otherwise stressed your credit, you may not qualify for a low enough rate for refinancing to make sense.
- **Have you already stripped all the equity out of your home?** To get the best rates, you'll need to keep your borrowing to less than 80% of the value of your home. Refinancing might not make sense if you've already borrowed 90% or more of your home's value in mortgages and home equity loans.
- **Do you have a spending problem?** Taking out extra cash during a refinancing to pay off credit-card debt is a popular tactic these days -- and a huge potential mistake. You've turned what should be short-term debt into long-term debt, which can cost you more in the long run despite the tax advantages from being able to write off the interest. You've also put your home at greater risk and compromised your financial situation should you ever have to declare bankruptcy.

Cut up the cards

In fact, "people who take out money to pay off credit cards and have no intention of changing their credit-card behavior" are No. 1 on economist Doug Duncan's list of those who shouldn't refinance. These overspenders usually continue racking up big debts and sucking out more of their home's equity, leaving themselves vulnerable to bankruptcy and foreclosure. Duncan, chief economist for the Mortgage Bankers Association of America, believes people with big credit-card debts need to learn to live within their means before they even consider tapping their home equity.

I'd make the caution even stronger: You need to be willing to cut up your credit cards and live on cash, so you don't find yourself underwater in a few years.

To determine whether refinancing makes sense for you, you'll first need to jettison the idea that there's some rule of thumb that can make the decision for you. It used to be, back in the day when everybody got 30-year fixed mortgages and refinancing costs were high, that interest rates had to fall at least two points below your current rate for refinancing to make sense.

Now there are so many different kinds of mortgages -- 20-year fixed, 15-year fixed, adjustable rate and hybrid mortgages that are fixed for three to 10 years before becoming adjustable -- and so much competition driving down costs that rules of thumb don't really work anymore.

Set goals, read up, calculate

Here's how to know if you should refinance:

Define your goals. Do you want to lower your monthly payments? Build equity faster? Get money for a home improvement project or other cause? Each goal will affect the kind of loan and terms you'll face.

"Once the goal is established it is pretty easy to see if (refinancing) makes sense or not," said mortgage broker Allen Bond of Palos Verdes Funding in Palos Verdes Estates, Calif. "Some people are actually going from a 30-year to a 15-year loan and increasing the payment, but saving considerably over the long run. For those that just want (lower monthly payments), that would not make sense."

You may be able to accomplish more than one goal, though. Duncan, for example, recently refinanced from one 15-year loan to another at a lower rate. He not only lowered his payment but got cash out to help pay for a child's college education. (He did have to pay a slightly higher rate than had he simply refinanced what was left of his mortgage balance -- typically taking cash out of a refinance will increase the rate you pay.)

Educate yourself. Read about how the refinancing process works, get a copy of your credit report and score so you know how lenders view you, and start shopping for rates and terms.

Start with your current lender, who has an incentive to try to keep you as a customer. Don't stop there, however. "There are 7,500 lenders out there," Duncan said. "If you're talking to just one, you're not taking advantage of the competition."

Web sites such as E*Loan can give you a good idea of what the costs are for refinancing to a variety of different loans. You can also call several lenders or use a mortgage broker (preferably one who's been in the business several years and who is affiliated with National Association of Mortgage Brokers) to help you review your options and the associated costs. Working with a good broker can be especially smart if you have troubled credit, since the rates typically quoted on Web sites may not apply to you and you're at greater risk of being a victim of so-called "predatory lenders."

Ask about all the costs of a loan, including all the points and fees you'd be expected to pay. Technically, lenders aren't required to disclose their charges in what's known as a "good faith estimate" until three days after you actually apply for a loan. But reputable lenders will be happy to disclose their costs if you ask.

And don't, by the way, buy the idea that there's such a thing as a "no cost" refinancing. Loans always have costs, although they can be disguised as a higher rate or fees that are added to your principal.

Run the numbers. Once you've got some options, you can compare them to the costs of the loan you have now using one of the mortgage refinancing calculators available on the Web, such as the one at Bankrate.com (see link

at left.) This can show you your "breakeven" point: when (or if) the savings from the new loan would offset the costs of refinancing.

If you're going to be in the house long enough to reach that breakeven point, you might want to proceed.

There are two caveats here, however. Sims, for one, doesn't believe in spending money on a refinancing if the breakeven point is more than three years away. That's too long to wait for a payoff, he says, and many homeowners will end up selling their homes before they reach that point.

Look at the total costs

You also need to look at the total costs of the loan over the long term. Even if you have a much shorter breakeven point, for example, you could wind up paying more for a new loan if you're several years into your current loan or if you've made substantial extra payments on your mortgage.

Rasik Desai, a New Jersey homeowner, discovered he wouldn't be much better off refinancing his mortgage, even though he could get a much lower rate and lower his monthly payment.

In 1993, Desai got a 30-year mortgage for \$97,500 with a 6.75% fixed rate. Four years later, he began making \$200 extra payments each month to pay down the principal. Even though he can get a 15-year mortgage on the remaining \$68,000 balance for a lower rate -- 5.5% -- he discovered he'll pay less over the long haul by keeping his current mortgage.

"If I do not refinance and continue to prepay \$200 a month extra, I will be paying off my mortgage in 110 months," paying a total of \$91,670, Desai said. If he refinances and continues prepaying the mortgage, it would take longer to pay off the loan -- 117 months -- and cost slightly less: \$88,457. But add in the \$2,600 costs of the refinance, and his pre-tax savings would be just \$614. Desai has decided it's not worth the bother.

Stretching out your payments just makes matters worse. People who are 20 years into a 30-year mortgage will find they can spend tens of thousands of dollars more over the long run if they refinance into another 30-year mortgage.

Once you're far into a loan, "most of what you've got left to pay is principal anyway," Sims notes. "You might as well keep paying (on your old loan)."