



How to Make the Most From Refinancing

Description

For most homeowners, mortgage payments dwarf all other living expenses. When an opportunity comes to reduce those payments, many jump at it. Some homeowners, however, jump a little *too* quickly.

Turning down free money

In evaluating the benefits of refinancing, financial planners often compare the expected reduction in monthly payments against the costs associated with refinancing. When the amount saved exceeds the costs by more than a tiny amount, planners will often recommend that homeowners replace their current mortgage.

It's hard to argue against saving money. But by focusing on how much you can save, a surprisingly large number of mortgage borrowers — nearly a third — save less than they could by refinancing too early. These results fly in the face of those who say that many borrowers wait too long before they refinance their mortgages, even when interest rates have dropped substantially.

Weighing the costs

The analysis hinges on the reality that refinancing costs money. If you could refinance for free, you could grab a few extra dollars every time interest rates experienced a small dip. But when you consider mortgage application fees, title insurance premiums, and other closing costs, you can't afford to refinance every day.

Because of that, you should be very careful when you decide to pull the trigger. For instance, if you could save \$25 a month now, deciding to refinance may mean giving up the possibility of saving \$50 or \$100 a month if rates continue to fall. Although many personal-finance experts advise against trying to time mortgage rates in this way, only by treating the refinancing option as a rational economic decision can you make the most from your mortgage.

By analyzing a number of factors, including the size of your mortgage, the length of time you'll stay in your home, and the volatility of interest rates, the optimal time to refinance for those who intend to stay in their homes indefinitely is when rates have fallen 1%-2% from your existing mortgage. For those planning to move in the near future, rates may have to fall even further before it makes sense to refinance.

Look before you leap

This analysis of refinancing options serves as a reminder that many financial decisions are more complicated than they seem at first. It's smart to look for savings anywhere you can. But by jumping at the first opportunity to save small amounts, you could give up the chance to reap bigger savings later.

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