When Mortgage Refinancing Is an Excellent Idea

In mortgage refinancing, a property owner, often someone who has a mortgage on their home, takes out a second mortgage that has better terms than the first mortgage did. In the process, the mortgage holder pays off the old mortgage, essentially replacing one loan with another. If the new mortgages terms are chosen carefully, mortgage refinancing can be a valuable method of improving ones finances.

For instance, a lower interest rate is generally a sign that a mortgage is a good investment. In determining the total cost of any type of loan, the interest rate is the variable with the most weight, so a mortgage with a lower interest rate usually offers substantial savings. However, if a new mortgage offers a lower monthly payment, but the interest rate is no lower than the old mortgages interest rate, the new mortgage will have a higher total cost. This effect can be seen in mortgages that have a higher interest rate but drop the monthly payments by extending the term of the loan. This type of loan should be chosen only when the homeowner is having difficulty making higher payments at the moment, but foresees being able to pay more per month in the future.

Another consideration is whether there are "hidden" fees associated with either the new or the old mortgage. For example, it is common for a mortgage to have fine print that requires the holder to pay a penalty if the mortgage is paid off within a set time after taking out the loan. The penalty is designed to prevent the mortgage holder from closing the loan too early for the bank to make a decent profit. Most mortgages have this kind of penalty attached, and normally the penalty period does not pose a problem. For instance, when the penalty period is one year on a twenty year loan, it is exceedingly unlikely that the mortgage holder will be able to get mortgage refinancing or to pay off the loan out of pocket within the penalty period. However, a longer penalty period can be troublesome, and can effectively prevent a homeowner from getting mortgage refinancing during a period of exceptionally low interest rates. The savings of a new mortgage with better terms may be completely offset by the fees incurred by paying off a mortgage within the penalty period.

However, mortgage refinancing is a sound financial move if the first mortgages penalty period has passed, interest rates are low, and fixed rate mortgages are available. Paying attention to all the terms, including the ones the lender does not point out, can pay off in major savings. With some thought and care, mortgage refinancing can lead to increased financial stability and a bright financial outlook.

About the Author

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