Mortgage Refinancing Explained

If you have never done it, mortgage refinancing can seem complicated. But when you put it simply, the process is easy to understand. When you refinance your home, you are essentially replacing your current mortgage with a new mortgage. In doing so, you use proceeds (or some of them) from the new loan to pay off the balance of the existing mortgage. If the interest rate is lower than when you initially purchased your home, you may be able to lower your monthly payment. Plus, in some cases, mortgage refinancing also lets you "cash out" some of the equity you have built up in your home. This allows you to use the equity for improvements or other expenses without having to sell your home.

Heres an example of how mortgage refinancing works: When Sarah purchased her home a year ago, she financed it with a 30-year fixed rate loan. At the time, she signed up to pay a 7.0% interest rate, but later this year, the rate fell to 6.5%. While a savings of 0.5% might not seem significant, refinancing at that rate would lower her payment by about $600 per year on the $150,000 loan.

Before you can decide if mortgage refinancing makes sense, you have to compare the savings to the costs of refinancing. In the example above, if you had to pay $3,000 (roughly 2% of the total loan) to refinance then it would take 5 years ($3000 / $600 = 5) to cover the cost of refinancing.   More Considerations

When you start to consider mortgage refinancing for your home, there are several important factors to keep in mind. Though interest rate seems like the most important aspect of mortgage refinancing, it is not the only thing that will affect your payment. If you are considering mortgage refinancing, consider the following:

1. The term of your mortgage. Oftentimes, refinancing your home implies extending the term of your mortgage. For example, if you have paid five years of a 25-year loan, you might need to be open to extending your total payments another five years if you select a new 30-year loan.

2. Your current credit rating. If your credit has deteriorated since you purchased your home, you may have trouble qualifying for a new mortgage at a better rate. The rules and guidelines for obtaining a mortgage are becoming more strict; without good credit, its more difficult to find a better rate, or qualify at all.

3. You future plans. For those that plan to stay in their homes for an extended period of time, mortgage refinancing can mean significant savings. If, however, you are considering selling your home within one or two years, you may actually lose money because of the closing costs and other fees required to refinance a mortgage. In many cases, it may take several years for the monthly savings to pay back the costs of refinancing.   Related We" title="Home loan">Home equity loan Mortgage rate Mortgage rates Loans

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