

Refinancing Advice and Other Ways to Save Money

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REFINANCING

To refi or not to refi, that is the question! Should I refinance? Can I refinance?

My first piece of advice is to “crunch the numbers.” Financial decisions should be made based on analytics and not emotions. Everyone’s situation is different and their financial needs and/or values are also unique; so, crunch the numbers and decide what works for you.

With rates still at a historical low, you can refinance your existing mortgage with a lower rate and possibly save hundreds of dollars a month. In addition to a Rate and Term Refinance – where you carry roughly the same balance as your previous mortgage - you may be eligible for Cash-Out Refinance, where you can receive additional cash by increasing the loan amount. Depending on how much rates have dropped, you may be able to take out additional funds, while still keeping the **same** monthly payments.

Another reason to consider refinancing through a Cash-Out Refinance is to accomplish debt consolidation. If you are carrying other debt (credit cards, a second mortgage, etc.) at a higher rate and/or the interest is not tax deductible, you may save substantially on your total monthly payments by consolidating other debt into one mortgage. (I do not recommend rolling a car loan into a mortgage. Why pay for the car over 15-30 years when you may not have it longer than five years? You will still be paying for it long after it is gone.)

One more reason to consider refinancing through a Cash-Out Refinance is to set up a reserve. Similar to an interest reserve, you borrow additional funds and put them aside. Then, you use those funds to make future payments or cover any payment shortage. For example, you borrow an additional \$15,000, which will cost you about \$80 per month with a 30-year fixed mortgage at 5%. You now have an additional \$1,000 each month to make your payments for 15 months or \$750 for 20 months or \$500 for 30 months, etc. Furthermore, putting those funds in the bank or in a secure investment instrument will partially offset the cost of interest to you. Do **not** put these funds in an investment with any risk orientation.

Especially since no one seems to really know the future direction and timing of interest rate changes and the health of the general economy, I would only recommend you Cash-Out Refinance if you currently have, or anticipate in the near future, a specific need for the funds. If you are out of work, experienced a reduction in your income or are worried about that happening to you, **and** are still eligible to refinance, you should strongly consider a Cash-Out Refinance to help get you through this period.

Another source of cash in a crunch is a Home Equity Line of Credit (HELOC). A HELOC is a mortgage (1st or 2nd) set up as a credit line, where you can draw it down and then repay it whenever and as many times as you want. It is a great source of emergency money, especially since a bank is an institution that doesn't lend you money when you really need it. Currently, banks have further restricted giving a HELOC and have even reduced or frozen a customer's open HELOC. However, the bank may reduce or freeze a HELOC's **undrawn** amount, ***but will not necessarily call in the outstanding balance, once it has been drawn.*** So, if you still have one available or can qualify for a new one and are uncertain about your near-term financial circumstances, you should consider drawing down what you can and holding it in a secure bank account. (Make sure the amounts deposited per individual in any one bank do not exceed the FDIC limit, currently \$250,000.) You most likely will not receive enough interest to cover your interest charges, but that is basically the cost of your "insurance" to make sure you have adequate funds in case of an emergency. Also, since the HELOC most likely has a variable rate, watch the rate carefully and monitor the cost and need for the money.

DO I/WE QUALIFY FOR A NEW MORTGAGE?

As a result of the current economy and previous lending practices, there is a real credit crunch going on. That means that financial institutions have developed stricter guidelines and are generally lending less. However, there are still many loan programs offered by banks and backed by Government Sponsored Entities that offer very attractive rates, especially for loan amounts up to the conforming loan balance limit, currently \$417,000.

The main four criteria for qualifying for a loan and a competitive rate are (1) credit score and history (2) verifiable income (3) the mortgage amount and (4) loan-to-value (LTV). LTV is the ratio of the loan amount to the house's value. For example, a mortgage of \$200,000 on a house valued at \$250,000 has an 80 LTV. ($200,000 / 250,000 = 80\%$.) (See below for more information on LTV, specifically if the value of your went down.)

The ***higher*** the credit score and verifiable income, and the ***lower*** the mortgage amount and LTV, the better off you will be to qualify for a mortgage, with a competitive rate. (See below for more information on credit score and history.) Additionally, banks look at your Debt-to-Income Ratio (DTI) during the underwriting process. This ratio shows what percentage of your monthly income is needed to cover your monthly debt (mortgages, leases, credit cards and any other loans). The lower the DTI, the better off you are. As a rule of thumb, your DTI should about 40% or below, but not more than 50%.

It is important to note that the bank does not look at other monthly expenses. So, they do not look at the costs of Yeshiva tuition, kosher food or other commitments associated with a Jewish lifestyle. Only you know what you can truly afford. But the bank may still qualify you based on the above four criteria and not your real cost of living. This means that even if you or your spouse has less or no income, but the other makes enough to cover the ratios, have only that one apply. If he/she qualifies alone, you

can refinance. (FYI, the non-applying spouse will need to sign at closing if title on the house is held jointly.)

CURRENT PROPERTY VALUE AND LOAN TO VALUE (“LTV”)

Unfortunately, in the current market, we have all experienced a decline in the value of our homes. Although the decrease is primarily recognized upon the sale of the house, the current market value of a property is a significant consideration and may have a material impact on your mortgage qualification and terms (specifically, the interest rate). So when the value of your home goes down and your mortgage does not, your LTV will go up. If your LTV is considered too high, you will be declined when applying for a mortgage.

If you are qualified for a mortgage with an LTV of over 80%, you will be required to pay Personal Mortgage Insurance (“PMI” or “MI”). Typically, the PMI will be added to, and incorporated in your monthly mortgage payments. In some cases, you may make a lump sum payment closing. For FHA loans, you will be required to pay a portion of the PMI in advance (which can be rolled into the loan amount, so you did not need as much cash up front).

It is important to note that even though I have yet to meet someone who likes PMI, remember to crunch the numbers. **Even with an “increased” payment as a result of PMI, your total monthly payments can still be lower or the same (with Cash-Out) and a refinance would make sense.** (FYI, when your loan balance becomes less than 80% of your house’s value, you can apply to have the PMI waived/terminated. This situation occurs when you have paid down enough of the principal and/or the market value of your house has increased. This is an important point to keep in mind for the future.)

Whatever the reason, if you have an LTV of over 80%, you will have to pay PMI, but you may also consider the following option when refinancing:

- Go for an FHA Mortgage. These loans are made through your regular Mortgage Banker/Broker, but are insured by the Federal Government and currently allow an LTV up to 96.5%, not including any PMI due at closing and rolled into the loan. (The current maximum LTV for an FHA Cash-Out Refinance is 85%, not including any PMI due at closing and rolled into the loan.) FHA Mortgages are a little more costly than a conventional mortgage, because of additional insurance and fees, but if you need the loan and are having problems getting approved as a result of the LTV, this program is one to consider. (FYI, the current FHA loan programs have applicants with above average credit scores. They are simply geared to providing loans in cases where traditional loan program requirements cannot be met, which is especially helpful in these times, when traditional lenders have tightened up lending guidelines and practices. Getting an FHA mortgage is *not* indicative of any social status. It just another one of many loan programs offered by your Mortgage Banker/Broker.)

If you have a first and second mortgage, please note the following:

Mortgage liens have priority based on the date they were made. A new mortgage will have a lesser lien position than an existing one, **unless** the existing

one “subordinated” itself. This means the existing (second) mortgage will allow the new one to go ahead of itself and maintain a first lien position. The main mortgage on your property will ***always*** need to be in the first lien position. If you have a first and second mortgage, you ***cannot*** refinance the first mortgage without the second, ***unless*** the bank holding the second mortgage subordinates its loan. (The bank holding the second mortgage charges a fee for subordinating and it usually takes a few weeks.) If you have a first and second mortgage that have a Combined LTV (“CLTV”) of over 80%, you will most likely only be able to combine the two mortgages into one and depending on how high the CLTV is, an FHA Mortgage may be your only option.

DOES IT PAY TO REFINANCE?

The rule-of-thumb ***used*** to be it was worth refinancing if the rate you could secure was a full percentage point below the rate on your current mortgage. Please disregard that concept. Besides my advice to crunch the numbers and see what a refinancing is worth to you personally, in your current situation, you may actually be pressed to refinance. Additionally, you should know that the cost and process of refinancing has been streamlined over the years. The process ***should*** be painless and almost effortless – and if structured intelligently, you can begin saving in the first month, instead of waiting to recover the costs over a period of time. Most people feel it is not worth the bother to refinance to save a few dollars a month, but how much your time is worth is your personal decision. FYI, a reasonable cost to refinance in New Jersey – including Bank Fees and Title Insurance/Fees – is between \$3,000 and \$3,300, which you may not even have to pay up front.

WHAT TYPE OF MORTGAGE?

Fixed or Adjustable Rate:

With the current rates (about 5%), I recommend a fixed rate mortgage. You know what rate you have and how much it will cost you. You do not have to worry about rate fluctuation. If you have an adjustable or variable mortgage, your rate and payments will change periodically with the market. If rates go down, so will your rate and payments - and vice versa. Historically ***and*** rationally, there is only so much better you can do than 5%. If rates drop another percent or two, you will gain, but if they increase you will lose. Not only because of increased monthly payments, but if rates rise quickly or high enough, you may not be able to refinance and may be stuck in that variable rate loan. In the 1980s, rates were 15-20% and no one really knows how the current economy will affect rates down the road.

Case in point – someone I know had a second mortgage with an adjustable rate tied to the prime rate. Prime went below 4% and he was “saving” money, since the average mortgage rate at that time was in the 5-6% range. Then prime suddenly shot up to over 8% and he wasn’t adequately prepared when his payments practically doubled.

FHA or Conventional Mortgage:

The positive and negative aspects of an FHA Mortgage were previously discussed in detail. If you qualify for, and can manage with its restrictions, take the Conventional Mortgage. It will generally be less expensive overall.

Length of Mortgage Term:

10, 15, 20, 25 or 30 years? The most competitive rates today are for a 15 or 30-year mortgage. Ironically, the rate for a 15-year may be only ¼ percent less than a 30-year (not much of a spread), but the monthly payments could be 50% **more**, since you save so much in interest – more so from the shorter term than the lower rate. However, it is important to remember, especially in cash-tight times, that you can, through voluntary prepayments, make a 30-year into a 15-year mortgage, but cannot do the opposite. You cannot extend a 15-year mortgage. If it becomes too costly and you cannot refinance at the time, it will be extremely difficult for you. **So, unless you can really afford the 15-year payments without issue, take the 30-year and pay extra when you can. But if times are tough, you can fall back on the lower payments of a 30-year mortgage. (FYI, one extra payment a year will pay off a 30-year mortgage in about 23 years.)**

OTHER WAYS TO SAVE

Try to pay your expenses with cash, check or a debit card. You will see and feel your limits quicker and reduce impulse purchases. If you do or must use a credit card, then always pay your balance in full at the end of the statement cycle. Do not simply make the minimum payments. You will either get stuck on the “interest treadmill” – sweating, but not actually getting anywhere, or worse yet, if the minimum doesn’t cover the interest charges, it will actually increase your principal balance and future finance charges and set you back. However, if you must keep an outstanding balance then consider the following:

- ❑ Call your credit card company and ask for a better rate or to waive a finance or late charge. Explain that you are a good customer. Either because you make all your payments timely or **because** you carry a balance, they are making money off of you. Do not threaten, but insinuate that you may have to take your business elsewhere. You may have received other credit card solicitations, with more favorable rates and benefits, etc. Many credit card companies will just cut the interest rate right over the phone and/or waive some charges.
- ❑ Consolidate, change or shift credit cards. You may be able to transfer credit card balances to one with a lower rate. Remember when you open new or too many credit cards, your credit score may be negatively impacted. Also, read the fine print regarding the cost and terms of a new card, including annual fees, balance transfer charges, teaser interest rates or limited time offers. The true savings may not be as much as you thought or even worth it. You do **not** want to keep on revolving or getting credit cards - it will hurt your credit score.

- Have specific tasks for your credit card. When you pay your balance in full within the grace period, you pay no finance charges. However, when you have an outstanding balance after the due date, you then lose the grace period and are charged finance charges from the day you charge something – not the day when your bill is due. So, you will start to accrue compounded interest from the “1st” of the month and not the 25th or 30th. Therefore, you should use one credit card for whatever amount, or the purchases that you can pay off each month, and leave the outstanding balances or charge the additional purchases on the other card. For example, if you can only afford to pay off \$2,000 in monthly credit card purchases, use one card for that amount and pay it off in full at month’s end. If you will spend more than that, use the other card for those purchases. **Always make sure at least one card is paid in full.** If you have \$6,000 in outstanding credit card balances and have two cards, it is better to keep the balance on one card and the other paid off in full, then to have \$3,000 open on each card and paying finance charges on every purchase from day one. Of course, the savings will be dependent on the interest rate of the card carrying the outstanding balance; therefore you should select the card with the higher rate to be your paid-off card and the card with the lower rate should be the one on which you leave an outstanding balance.

GENERAL DEBT ISSUES

Credit Score:

Based on your history, there are three main Credit Bureaus that analyze and assign your credit worthiness with a score between about 400 and 850. (The highest I have ever seen was an 830.) Your qualification and rate will depend on this ranking. As a result of tighter lending practices, 680 has become the minimum score needed to get a reasonable mortgage interest rate, 720 is considered pretty good, 780 is great and over 800 is unbelievable.

Be advised that every time your credit report is run you lose some points off your score. It can be from 2-10 points. That is why it is not a good practice to shop all around and let anyone or everyone run your credit. Only run your credit when you are serious about getting a loan or credit. Typically, the best way to get a mortgage is to find a single Mortgage Banker or Broker whom you trust and let him/her run your credit. You could and **should** shop his/her rate and fees to ensure they are competitive, but if you go to multiple Banks and/or Brokers and each runs your credit, it will suffer – and so will your interest rate or even your ability to qualify.

However, I do suggest that you check your credit at least once a year. Besides being an effective way to find identity fraud, you will be able to see any negative events that have affected your credit score. Some may be inaccurate and your score will have suffered unnecessarily. It may be for a debt in collection for a few dollars or more, that you actually paid, or an automatic late posting, when you were assured otherwise when in contact with the creditor.

FYI, you are entitled to periodically receive a free copy of your credit report from the Bureaus. (Be careful about offers for a free report that then commit you to a monthly service or fees.)

Pay a Little Extra:

As long as you are able, always pay a little more than the required minimum payment on your most expensive, on an after-tax basis, loans. Over the life of the loan, you will save considerably more than your “extra” payment. Pay down higher rate loans, like an auto loan (not lease) or credit cards, before paying extra on your home mortgage. Besides probably having a lower rate, a home’s first mortgage interest, subject to certain size limitations, is (still) tax deductible, while other debt may not be. (Credit cards and automobile loans are not, education loans or second mortgages *may* be.)

I hope these points and tips were helpful and wish you much success. Check back periodically for updates.

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