



Five Steps to a Successful Refinance

As mortgage rates dip to multiyear lows, many homeowners wonder if a new loan could save them money. Others fear the rate on their adjustable-rate mortgages might move up significantly and crave the certainty of a fixed-rate loan.

Whatever the reasons, mortgage refinance activity has exploded in recent weeks. Perhaps you are among the millions planning to swap your old mortgage for something better.

If so, there are five crucial steps you need to follow to guarantee a successful refinance:



Step 1: Weigh the pros and cons

A refinance allows you to take out a new loan that pays off your current mortgage. Although you are then obligated to make payments on the new loan, your costs typically are lower after refinancing.

A new mortgage with a rate that's just a half-percent lower may save you hundreds of dollars each month.

Refinancing allows you to enjoy a do-over if you didn't get the mortgage process right the first time. It sounds simple: Refinance and save.

But it's important to look beyond the immediate monthly savings, warns Mike Dubis, a Certified Financial Planner in Madison, Wis.

"Consider how much interest you'll be paying with a new loan in total, compared to what you've already paid with your old loan," he says.

For example, if you've had your mortgage for 10 years, you've paid mostly interest thus far. Lenders structure loans so that borrowers pay off interest charges in the first years. After that, more of the monthly payment reduces the principal owed.

"Even though your monthly payment is lower, you might be paying more interest over the life of the new loan than you've got left to pay on your old mortgage,"

Dubis says. "Besides that, if you take out another 30-year mortgage, you might be still paying that thing when you're retired."

For those who want to refinance yet still hope they'll someday own their home free and clear, lending companies often provide loans with terms matching the years left on your old mortgage. Or they offer terms of 10, 15, 20 and 30 years.

Rates often -- though not always -- are lower on loans with shorter terms. However, monthly payments on these loans tend to be higher. The lure of low monthly payments is the reason many homeowners keep selecting new 30-year loans.

Many middle-class families live paycheck to paycheck, and a new 30-year fixed-rate loan with more economical payments may be their only realistic option, says Margot Saunders, counsel to the Boston-based National Consumer Law Center.

"It gives them some flexibility," she says. "They'll have a little extra money each month."

In some cases, it makes financial sense to refinance. In other situations, it does not. How do you know if refinancing is the right choice?

It's often said that if you can recoup the cost of a refinance in a year, it's worth doing. But that maxim is too simplistic and ignores a host of other important considerations.

In addition, many experts urge homeowners to take advantage of today's historically low mortgage rates by sticking to a 30-year or 15-year fixed-rate mortgage when they refinance. However, mortgages that recently have fallen out of favor -- such as adjustable-rate and interest-only mortgages -- also may make sense for some borrowers.

If you have questions about whether a refinance is right for you -- and if so, which type of loan you should choose -- consider talking to a fee-only Certified Financial Planner.



Step 2: Gather important documents

If you took out a mortgage a few years ago during the housing boom, you may be surprised at the increased scrutiny lenders now apply to potential borrowers.

You'll need to prove -- through bank statements and pay stubs -- exactly how much money you have coming in and how much you have in reserves.

If in doubt, don't throw it out. Instead, save recent pay stubs, as well as the last few income tax statements and W-2 forms from your employer.

Bank and brokerage statements for at least the past couple of months often are required.

"For people who do all their banking online, I suggest printing out your statements," says Brian Short, executive director of the Tennessee Association of Mortgage Brokers.

Know your credit score before you refinance. Only homeowners with stellar credit will qualify for the best rates.

"As soon as you think you're going to refinance, get copies of your credit reports and make sure there aren't any errors that will drag your score down," says Rick Palandri, president of 1st Mortgage of Illinois in Bloomingdale, Ill.

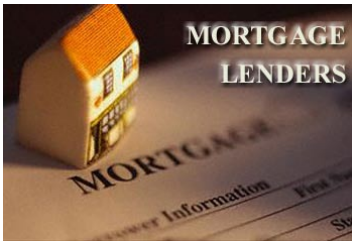
Errors can be corrected, but it takes time to inform the credit bureaus of mistakes. So the sooner you check your credit, the better. You can get a free copy of your credit report at AnnualCreditReport.com. If you also want your credit score, you'll need to pay a fee.

Lenders approve borrowers based on credit scores derived from information found in credit reports.

When a customer indicates serious interest in a mortgage, many lenders will offer a free initial information session. As part of this service, the lender will pull your credit score for free, says Jerry Surface, owner of Pinehurst Mortgage in Pinehurst, N.C.

Be careful not to spread your loan inquiries over a long stretch. Multiple credit inquiries from auto or mortgage lenders are usually ignored by companies that produce scores for a 30-day period, explains Craig Watts, public affairs manager for Fair Isaac Corp., the company that pioneered credit scoring. After that, additional inquiries can bring your score down. Some older scoring models allow only a two-week span before inquiries can damage your credit score.

Once a representative has your credit score and other important information -- such as documentation of your current monthly debt load and income -- she will discuss your particulars with you and explain whether you qualify for a certain loan.



Step 3: Shop several lenders

Everybody wants a new loan that matches their needs at the best terms and is offered at a reasonable cost. That means finding the right lender.

If you were satisfied with the firm that provided the loan you have now, start shopping with your current mortgage provider, suggests Barry Zigas, director of housing policy for the Consumer Federation of America in Washington.

"If you tell them you want to refinance, they may not want to lose your business, and will cut costs," he says.

Also, consider shopping around to see what other lenders are offering. When shopping for a loan, check with different types of lenders, including banks, credit unions and mortgage brokers. The more you compare rates and closing costs, the more confident you'll be that the loan you decide on is fair, Saunders says.

Remain suspicious of any lender that comes to you unsolicited. Such offers could be scams, says Kathleen Day, spokeswoman for the Center for Responsible Lending in Durham, N.C.

"Any time (lending companies) contact you, it's a red flag," Day says

Today's declining housing market may make it more difficult to qualify for a loan. Because home prices have dropped, appraised values may pose a problem now, Short says.

For instance, a homeowner who paid \$250,000 for a home and took out a \$215,000 mortgage may find that a new appraisal indicates the home value has sunk to \$230,000. In this situation, a lender may be unwilling to provide a new \$215,000 loan, which would be more than 90 percent of the home's \$230,000 value.

Lenders are leery of mortgages within 5 percent or 10 percent of home value, fearing prices could drop even further until the home price wouldn't fully back the loan.

A mortgage insured by the Federal Housing Administration may be the only viable option for homeowners in this situation, Short says.

Call lending companies and ask if they offer FHA loans. Not all firms do, but more lending companies are becoming FHA-approved, with some 12,500 nationwide with 25,000 branch offices now offering the loans, says Lemar Wooley, a spokesman for the federal Department of Housing and Urban Development, which oversees FHA loans.



Step 4: Ask about all fees

When you take out a mortgage, you incur a host of small fees known as closing costs. These can easily tally \$2,000 or more. So it's crucial to ask all prospective lenders for a detailed breakdown of these fees.

Within three days of applying for your mortgage, law requires that you receive a "good-faith estimate" of these charges, explains John O'Brien, chairman of the Illinois Real Estate Lawyers Association.

However, you should expect the lender to give you specifics on all costs before you pay a couple of hundred dollars in a loan application fee, Saunders says.

Charges associated with a new mortgage include the application fee, credit check fee, appraisal fee, origination fee, document processing fee and

underwriting fee. Other charges may go by various names, including copying fees, broker fees and yield spread premiums.

Title charges are also part of a new loan's cost structure. These include the cost for the search that ensures the home title is clear, title policy insurance and a closing or settlement fee. Other local recording and tax transfer fees also apply.

Depending on the circumstance, Short notes, borrowers may find that a good-faith estimate of closing charges also includes sums for property taxes or insurance payments. However, your current lender likely will refund this money at closing.

When consumers use a mortgage broker (as opposed to a bank), looking at the good-faith estimate may not provide enough information to decipher exactly how much money the broker is making on the loan, Zigas says. For instance, the broker may earn a fee from charging a slightly higher rate on your loan, known as a "yield spread premium."

"Ask him specifically what he's getting, and if you don't think it's fair, say so," Zigas says.

Knowing that consumers aren't eager to write a four-figure check to secure a new loan, lending firms typically offer "no-cost" refinancing.

But there's no such thing as a free loan. With a no-cost refinance, lenders usually charge a slightly higher interest rate and roll the costs into that higher rate charge.

Alternatively, borrowers often can tack closing costs on to the mortgage amount they seek.



Step 5: Watch the little details

Once you've selected the lender and loan that is best for you, it's time to apply for a refinance. From this point forward, it's important to keep an eye on the small details that can make a big difference to your bottom line.

Because mortgage rates move up and down -- sometimes significantly -- from day to day and week to week, it's important to lock in your rate when you find a good deal. A rate lock is a contract guaranteeing that the rate your lender offers will remain in effect for a specific period.

"Most people lock in their rate so they get the rate at closing that they were (quoted) at application," lender Palandri says.

Ask your lender for a rate lock that doesn't cost you anything -- or at the very least, a minimal amount. Moreover, look for a lock that guarantees your rate won't go higher, but will go lower if mortgage rates continue to fall.

You may feel great relief once the application process is over and you are ready to close. But it's important to remain vigilant, particularly in terms of extra fees.

Although a good-faith estimate of closing costs lists the charges for your loan, it's not always exact. It can be especially complicated to figure out exactly how much homeowners insurance and property taxes must be paid at closing, Short says.

"If, for example, property taxes are due Oct. 1 and you're closing in September, you may be asked to bring in the tax due so they can be sure they are paid," he says. "Then you'll be reimbursed later for the property tax money sitting in your current lender's escrow."

Additionally, borrowers may be asked to prepay some interest charges, O'Brien explains. If they close in the middle of the month, for example, they may need to pay interest for the remainder of the month.

Make sure you have enough extra cash in your savings account to cover these extra fees. If you don't think you can do so, talk to your lending firm about adding the extra amount to the mortgage principal you're requesting, Short says.