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When Is Refinancing In Your Best Interest?

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By PATRICK BARTA

Question: My husband and I are currently in the eighth year of a 15-year mortgage. Our monthly payments are approximately \$1,700 and we have \$131,000 left on our loan. Does it make sense to refinance for another 15 years at 5.375%? It would reduce our payments to \$1,100 a month but since we currently pay more principal than interest, we're uncertain which direction to go. We are in our early 50s and our children are both graduating from college this year. Your thoughts, please.

—Pat, Chicago

Pat: Don't worry about the fact that you're already halfway through the term of your mortgage. There's an easy way to make your refinance make sense: Pay down your loan early.

To illustrate this, consider a hypothetical scenario based loosely on your experience, provided by Bankrate.com, the consumer-finance web site. This scenario assumes that you took out a 15-year, \$200,000 mortgage at 6.5% interest seven years ago, with a monthly payment of \$1,740. The balance on this loan would now be about \$130,000 and you would have paid a total of \$76,500 in interest. If you keep the loan, you'd wind up paying another \$37,100 in interest over the next eight years.

Now, let's say you decide to refinance. Doing so will likely cost you about \$3,000 in fees. So whatever you do, you'll want to make sure you save more than \$3,000 in interest over the life of your new loan, meaning that you'd want to pay no more than \$34,100.

Simply refinancing into another 15-year loan (at today's rates of around 5% or less) and paying it down over the full 15 years probably isn't the best move, though it certainly would give you some more pocket change in the short run. Your monthly payments would drop to \$1,028, saving you more than \$700 a month. But you'd pay \$55,045 in interest over the next 15 years, far more than you'd have to pay if you simply kept your old loan.

If you refinance into a 10-year loan, the math looks a bit better, but you still don't come out ahead on interest. Total interest over the 10-year span would be \$35,500. With your closing costs added in, it's not a good deal.

Paying down your loan early, however, can dramatically change the numbers. Say you refinance into a 15-year loan at 5% interest and continue to make your old monthly payments of \$1,740 a month until the loan is finished off. Under this scenario, you'd be done with your loan in seven and a half years, with a total interest bill of \$26,000. Even after paying closing

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costs, you'd save several thousand dollars on interest and be free of debt before you would have been had you kept the old loan. The numbers are more or less the same if you refinance into a 10-year loan and continue to pay \$1,740 a month.

Of course, there are other ways to configure the payment schedule; for example, you could choose to pocket a little bit of the monthly savings if you want some more spending money and still finish ahead. For example, you could pay \$100 less each month than with your old loan and wind up paying just \$28,000 in interest over the life of the new one -- still a healthy savings; plus, you'll be free of debt in about eight years, the same as before. The critical point is to avoid extending the term of your mortgage. For example, if you only have eight years left on your home loan, you don't want to make payments for more than eight years on your new loan. And you most certainly wouldn't want to refinance from a 15-year mortgage into a 30-year loan. Pay as much as you can each month -- it only saves you interest in the long run.

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