

BUSINESS

Home mortgage news:

It's more than just refinancings

By KENNETH POLIN

Yes, here we go again. Yields on 30-year U.S. treasury bonds have fallen to their lowest levels in 20 years, and mortgage rates have tumbled as well. Consequently, another wave of refinancings has flooded the mortgage industry.

Do not be guided by the old maxim that preaches refinancing if a two-percent saving in interest rate can be garnered. For example, a potential saving of four percent may hold insufficient attraction if an imminent move is planned. On the other hand, given the high amount of today's mortgages and the low interest rates available, for some homeowners, a refinancing might make sense if a one-percent saving can be obtained.

Therefore, refinancing a 30 year \$250,000 mortgage from eight percent, with monthly payments of \$1,834, to seven percent, with monthly payments of \$1,663, might cost \$5,000. That total cost, time value of money and tax consequences aside (consult a financial advisor, tax attorney, or accountant for proper guidance), could be recovered in about 2 1/2 years: \$5,000 divided by monthly savings of \$171 equals less than 30 months. Hence, the "break-even" period — the time it takes to recoup the costs of the refinancing — is less than 2 1/2 years. (While some refinancing programs cost nothing, their interest rates usually are not attractive.)

Accentuate the possible

Some homeowners also like to accentuate the possible cash-flow benefits of refinancing even further. For example, if the \$5,000 in refinancing costs were built into the new mortgage, instead of paying those costs out-of-pocket, the break-even period would be lengthened by only seven months.

In fact, a refinancing also allows homeowners to avoid paying the mortgage for one month, during the month after the closing. Mortgages are paid one month in arrears (the same as paying a restaurant after the meal has been eaten). Thus, in terms of payments actually made, the break-even period may be cut by a year or more.

In the final analysis, for homeowners who foresee staying in the residence sufficiently long to recapture the costs of refinancing, the best time to refinance usually is when rates are lowest (credit concerns aside).

Keep in mind that interest rates tend to increase faster than they descend. A financial advisor or accountant may help provide the guidance needed to make a prudent decision.

Mortgage trends

Given today's low rates, homeowners frequently are refinancing from adjustable rate mortgages (ARMs), whose popularity had skyrocketed in recent years, to traditional fixed rate mortgages. Even though there may be no savings in interest rate, today's rates may provide an opportunity to secure a low fixed rate for those homeowners not planning to move.

Higher leveraging tends to be the goal of sophisticated borrowers. Generally, the higher the mortgage, the greater the tax deductions. In addition, borrowing more money leaves more dollars to invest elsewhere.

For example, as homeowners paid single-digit interest rates on mortgages, blue-chip stocks, as per the Dow Jones industrial average, have increased each of the last three years by more than 20 percent. Therefore, by taking \$100,000 of additional mortgage, a homeowner could earn an extra \$10,000 in annual investment income (based on the difference of the investment return minus the mortgage rate, multiplied by the amount invested). Of course, some homeowners rest easier owing less money. Moreover, investments cannot be expected to continue producing such returns.

Hot loan programs

With high credit card balances outstanding, high loan-to-value home equity lines of credit (HELOC) and second mortgages have soared in popularity. Since credit card debts usually bear interest that is not tax deductible, their replacement with home loans also appeals to tax advisors.

Nonetheless, when these programs are used to mortgage properties in excess of their worth, not only are tax deductions supposedly lost but, more importantly, interest rates skyrocket. All too often, therefore, these programs saddle homeowners with the temptation to incur debt they cannot afford.

Even if the homeowner continues to meet the burdens of such debt, the family may be trapped into staying in a home where the debt far exceeds the market value. Simply put, upon a sale of the home, the seller would not have enough money to pay off the lender.

Much more appealing is the use of mortgage programs that permit high financings to purchase

homes. For those purchasers who can meet such payments, these programs are heaven sent. Today, those qualified can sometimes borrow 100 percent of a purchase price. Yes, 100 per-



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cent! Also, more programs are becoming available that avoid a borrower's incurring mortgage insurance, an expense not tax deductible.

For those who just want a low monthly payment, 40 year terms or interest-only programs may prove ideal. These programs usually carry initial rates fixed for up to several years.

What it all means

A flourishing economy and recent tax revisions on both the federal and state levels (e.g., changes in capital gains treatment on the sale of homes, and the New York State STAR program), have created a fertile marketplace for buyers as well as sellers to take advantage of today's low interest rates.

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