

Is Refinancing a Good Idea Right Now?

By Barrett Niehus

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IP Ware Real Estate Investment Software <http://www.freetrainer.com>

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Rates on mortgages are lower than they have been in forty years. This provides a huge opportunity for new and existing home owners, but also carries risks that can have a substantial impact your ability to pay in the future. Mortgage lenders are inundated with work, and it was recently reported on national news that "if you can breath, you can get a mortgage." This phrase should at the very least frighten the average mortgage customer. It indicates that not only are the mortgage companies finding new ways to make money off of their huge list of clients, but they are also circumventing the risk analysis that avoids putting high risk customers into immediate credit trouble.

The opportunity is immense. For many home owners, monthly mortgage payments can be reduced by ten to fifteen percent through a refinance. For new home owners, they can afford to pay ten to fifteen percent more because of resulting low monthly payments. The benefits are substantial and if addressed properly, the risks can be avoided.

The risk of course is choosing a form of financing with inherent uncertainties and putting your long term financial situation at risk. One of the most popular mortgage products available today are variable (floating) rate mortgages. The mortgage rate varies with the current Treasury rate until it is locked in at a set amount above the future treasury rate three to five years after the date of origination. Many mortgage customers are fond of this type of funding because it allows them to enjoy a very low rate for the next three or five years. Unfortunately, the risk involved with this type of loan is huge, and can have substantial impact on the customer's ability to pay.

Given that rates are at a forty year low, it is very probable that interest rates will climb substantially within the next three years. Although most of these variable rate mortgages have interest rate caps where the lock in rate will not exceed twelve percent, the impact of a rate increase during a lock-in period can be substantial. To provide an example, suppose you have a \$200,000 variable rate mortgage with a 5.5% interest rate. When you first originate the loan, your monthly payment will be \$1,135. If interest rates increase to 12% by the time of your lock in period, your payments will increase to \$2055 per month; where they will remain for the life of the mortgage. For many home owners this type of increase will quickly lead to default, eviction, and bankruptcy.

Keep in mind that mortgage lenders are sales people, and mortgage brokers are essentially selling you a product. They make money when they sell you a mortgage. With the current emphasis on low finance rates, they are inundated with business, and are more focused with getting the loan closed than with evaluating your future ability to pay. As sales people, they have been given a number of products to sell, and because of the current frenzy, have been given substantial leeway from the banks. Therefore, they can forgo many of the risk analyses that were necessary during leaner banking times and sell whatever mortgage product is available.

With mortgage brokers trying to fund all of the business that they are given, and with mortgage products that carry high uncertainties, the risk associated with purchasing or refinancing is higher than ever. If refinancing or funding a new mortgage is the best financial decision for your specific situation, be aware of the risks, quantify the benefits, and realize that your mortgage lender has a vested interest in closing the deal.

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