

Refinance Now? Maybe Not

By [JESSICA SILVER-GREENBERG](#)

WSJ: October 7th 2011

Mortgage rates have been hitting historic lows for five weeks in a row. But that doesn't mean you should refinance your mortgage just yet.

The average rate for 30-year-fixed-rate mortgages fell to 3.94% for the week ended Oct. 6, according to mortgage-finance giant Freddie Mac—the lowest on record. Rates on 15-year loans, meanwhile, have fallen to a record low of 3.28%.

While mortgage rates vary by region even among the nation's biggest lenders, they are down throughout the country for borrowers with excellent credit. Citigroup, the third-largest U.S. bank by assets, is pitching a 4.193% rate on 30-year-fixed loans and a 3.806% rate for 15-year-fixed mortgages. EverBank Financial of Jacksonville, Fla., is offering Cincinnati-area residents a 3.89% rate on 30-year fixed-rate loans.

Steve Walsh, who heads mortgage lender Scout Mortgage in Scottsdale, Ariz., says he has seen a surge in interest among borrowers looking to take advantage of low rates. "There's a feeling that rates are basically at the lowest they can get," he says.

But are they?

No one can predict the future, of course, but policy makers seem intent on pushing rates down even further.

The Federal Reserve, for example, is trying to move rates lower by buying more mortgage-backed securities. And Obama administration officials are talking to lenders about ways to reinvigorate the Home Affordable Refinance Program, a government initiative to help borrowers refinance even if they have little or no equity left in their homes.

The goal for both: to get rates low enough so that more people will find it beneficial to refinance. If people start doing it en masse, it could help the economy.

"In the short term, rates could fall," says Brad Hunter, chief economist for Houston-based Metrostudy, a housing-market research firm. "In the longer term, rates will rise as the economy starts to strengthen."

If that were to play out, then refinancing now, with rates still around 4%, could be a mistake. That's because the chances are good that if you own a home, and have significant equity in that home and good credit, you already have refinanced in the past few years. Because refinancing

involves costs—typically 2% of the mortgage value—it often doesn't pay to refinance every time rates tick down, tempting though it is.

"Don't become a refinance junkie," says Greg McBride, a senior financial analyst at Bankrate.com, a consumer-information site. "You pay for it later in the form of closing costs."

So how far do rates need to fall before it makes sense for you to refinance? Economists at the University of Chicago have tried to answer the question.

The ideal refinance rate must factor in closing costs, marginal tax rates, the number of years left on the mortgage and other factors, the economists say. Homeowners often make decisions based on faulty assumptions about rates, says David Laibson, an economics professor at Harvard University and one of the Chicago study's authors.

"Mortgage rates follow what we call a random walk, and don't bounce back from lows like most people assume," he says.

In other words, what goes down could keep going down—even if it goes up for a little while first. If you catch the first big dip, you can miss later ones that offer even better opportunities.

The economists produced an online calculator, at zwicke.nber.org/refinance/, that distills their theory into a tool that calculates how far interest rates need to fall for homeowners to derive value from refinancing—the "optimal" refinance rate.

For example, their formula suggests that a homeowner with a \$400,000 mortgage with 25 years left on a 30-year-fixed rate mortgage at 4.75% shouldn't refinance until rates fall to below 3.51%, assuming 2% closing costs.

The risk of waiting for a lower rate, of course, is that it will never come. If you are unwilling to take the gamble, your best bet is to negotiate hard on fees.

The conventional wisdom is that it doesn't make sense to refinance unless you can shave at least a point off your interest rate. That's because you don't want your "break-even" point—when your savings exceed your refinancing costs—to be longer than two years or so.

But if you can persuade your lender to waive the fees, or most of them, you might need only a half-point of savings to make a deal worthwhile, says Bankrate.com's Mr. McBride.

Last week, Michael Allison refinanced his \$417,000 mortgage on a three-bedroom California Ranch-style house in Santa Barbara, Calif. The 41-year-old fitness-center owner says he will save \$200 a month by switching from a 30-year fixed-rate mortgage at 4.87% to one at 4.25%.

"It's an absolutely great deal and didn't cost me anything," Mr. Allison says. His lender, Provident Savings Bank in Pleasanton, Calif., covered the closing costs after his real-estate agent made some calls to the firm.

With a little negotiation, homeowners can persuade lenders to cover their fees. "It's not a free lunch," Mr. McBride says, because borrowers get slightly higher rates in exchange—but it is a good way to minimize your upfront costs.

Another option that's growing in popularity: refinancing a home at a shorter term—say, 20 or 15 years. If you can find a rate that keeps your monthly payment about the same as you were paying on your old 30-year loan, the decision is a no-brainer, says Mr. Walsh of Scout Mortgage.

Lloyd Qualls, a 57-year-old accountant in Mesa, Ariz., decided to do just that. Last month he ditched his 30-year fixed-rate loan at 4.875% for a 15-year fixed-rate loan at 3.375%. While that boosted his payments by \$89 a month, it will shorten his payment period by 13 years and save him \$104,233 on interest over the life of the loan.