05/25/2007

Refinancing May Be Cure for ‘Payment Shock’

Adjustable rate mortgages are losing popularity with American homeowners. A study released Thursday by mortgage finance company Freddie Mac found that of all those homeowners that refinanced out of one-year ARMs in the first quarter of 2007, 89 percent switched into a fixed rate mortgage. The same survey, Freddie Mac’s “Refinance Product Transition Report,” discovered that 82 percent of those who refinanced out of hybrid ARM loans chose to try a fixed rate loan for their new mortgage. Compare this with the first quarter of 2006 when only 76 percent of hybrid loan borrowers refinanced into fixed loans.

A separate report reveals the major reason that ARM loans are losing their appeal. A new poll conducted by the online consumer mortgage resource group GuideToLenders.com concluded that the most popular reason for refinancing today is to lower rising mortgage payments. The survey found that this was the main concern for almost 30 percent of those polled during April of this year, a significant increase from roughly 20 percent in February 2007.

It is clear that housing and mortgage markets have shifted courses in the past year. Home sales and price appreciation has cooled off, and housing inventory has risen. Troubles in the subprime mortgage market have recently been brought to light as poor credit borrowers en masse have filed for foreclosure in the past several months. Most of these homeowners had adjustable rate loans of some type. During the housing boom, lending standards were softened and many home buyers got into the market with loans they did not truly understand and often could not truly afford.

And as 25 percent of all home mortgages nationwide are some form of an adjustable rate loan, many people are now facing resetting interest rates and skyrocketing monthly mortgage payments. It is no wonder people are turning to refinance loans with fixed rates. If you have found yourself in a similar situation, you should consider refinancing out of your unpredictable ARM loan into a fixed loan as soon as possible. Interest rates are still at historic lows, but they have been rising in the past few weeks and they are expected to continue to rise for a while. You may want to lock in fixed rate before interest rates go any higher. Or if your ARM loan has a little while before the rate resets you may want to consider refinancing right before that event takes place.

As you refinance, you should take into account that there will be closing costs involved. You may also be required to pay points on your new loan. These can add up to several hundred or thousands of dollars. (You may be able to roll your closing costs into your refinance loan balance though.) And if your current ARM-loan has a pre-payment penalty, you will also have to consider whether to refinance and take the hit or wait out the penalty period.

Yet even with the extra costs, if ‘payment shock’ from an increasing ARM loan threatens to send you into foreclosure, refinancing may be the best way to save your home!