

## Options in a Falling Interest Rate Environment

Congratulations! Interest rates are falling and you want to take advantage of this positive situation! Depending upon if you currently own a home or if you are considering buying a home you have lots of choices and decisions to make. Let's look at the current homeowner first.

In the past, homeowners were told that the general rule of thumb when refinancing your mortgage loan was to wait until rates dropped at least 2 percent below the interest rate on your current loan to make refinancing worthwhile. In today's market this is not necessarily true. It really depends on many factors. Here are a few to consider:

- How long do you plan on remaining in your home? If you plan on staying in the home for an extended length of time, even a 1 percent drop in rates can be to your advantage.
- How much are the closing costs with a particular lender? Take the total closing costs, divide it by the number of months you project you will be in your current home and compare it to how much your mortgage payment will be reduced. If the monthly amount of the refinance costs exceed the reduced mortgage payment, refinancing might not be right for you.
- Is your main purpose for refinancing to reduce your mortgage payment, pay off additional debt, make a major purchase, or remodel your home? If you have built sufficient equity in your home you may be able to do what is called a "cash out refinance." This means you can receive cash based on the equity you have built in your home. However, if you take "cash out" you will increase the amount of your mortgage loan. This could mean your monthly mortgage payment could go up even with a lower rate. Using the equity in your home is certainly a consideration in refinancing. When rates are stable many homeowners prefer to take out an equity line of credit rather than refinance. Make sure you weigh both options.

One advantage of refinancing that appeals to many homeowners is reducing the loan term. Many homeowners in a falling interest rate environment will go from a 30-year loan term to a 15-year loan term. The great news is that a 15-year loan can have a lower interest rate than a 30-year loan! This is a great option for any individual or family who knows they will stay in the same home for the duration of the mortgage term or who wants to build up equity more quickly. Most consumers assume that getting a 15 year mortgage will double their mortgage payment in comparison to a 30 year fixed rate loan but that is not the case. Here is a quick comparison for a \$200,000 mortgage. We will assume that the rate on the 30-year fixed rate loan is 6.25 percent and the 15-year rate loan is at 6 percent. The 30 year fixed rate loan would have a monthly mortgage payment of \$1,232.43 (not including taxes and insurance), total payments of \$443,319, and total interest paid of \$243,319. The 15-year fixed rate loan would have a monthly payment of \$1,687.71, total payments of \$303,789, and total interest payments of \$103,789. So for an additional payment of \$455.28 per month you would save \$139,530 in total interest payments. An important factor to consider is your monthly budget and your ability to

save. Do not stretch your monthly expenses to the point you have no reserves in case of an emergency in order to pay off your mortgage loan early. You also have the option of making additional payments to principal. Some consumers will make extra payments during the term of the loan which can also shorten your loan term.

If you are considering buying a home, a declining interest rate environment can have both advantages and disadvantages. While it is great to take advantage of the falling rate environment many consumers attempt to play the “waiting game.” They study the financial news and attempt to “predict” when to lock in the lowest rate. No one knows what the markets will do, not even the experts!

This would be a great time to talk about “rate locks.” Lenders give you the option to “lock in” a mortgage rate. This means your rate will be guaranteed for a specific period of time from the day you lock in the rate. It could be as short as 10 days and up to 30, 60, or even 90 days. Consider a rate lock as “insurance” against rising rates. Sure, you are locked at that particular rate, even if rates drop further, but you are also protected against rising rates. One option that some lenders make available is a “float down.” This option allows you within a specified time period to take advantage of a lower rate even if you were locked into a higher rate. Not all lenders allow float downs and they are less prevalent in a volatile market.

It is important in a falling interest rate market to get pre-approved so you can take full advantage of the best rates. In order to lock in the lowest rate you need to be prepared to go to full loan application as soon as possible. Meet with your lender and explore your options. Waiting can be hazardous to your wealth!

One of the most important things to consider when rates are going down is your ability to qualify for a more expensive home. Qualifying for a mortgage loan is based on both your total debt and income in relation to your monthly payment. Obviously the lower your interest rate, the lower your payment.

Your final consideration in a falling interest rate market is the type of loan that would best fit your needs. Traditionally most consumers choose a fixed rate loan when rates are going down. This makes sense for two reasons. First, the indexes upon which most adjustable rates are based may not go down as fast as rates are dropping, thus there will not be as big a difference between the fixed rate and the adjustable rate, especially on 3/1 and 5/1 ARM's. The second factor is the lower the current rate, the more likely rates are to go back up. This means if you choose an ARM loan it would be more likely that when your first adjustment is due, your rate will go up. If your rate goes up, so does your monthly payment.

When rates are falling, seek the advice of a mortgage professional as soon as possible. Be fully prepared to talk about all the options in this article and what will be best for your long-term security and peace of mind.