

Building & Preserving Wealth by Design - Not by Chance

QUALITY FINANCIAL CONCEPTS

Doug's Insights

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Another Bite at the Apple *“Your Mortgage Rate Above 5%?”*

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With the Federal Reserve increasing the Federal Funds rate and the expectation of one or two more rate hikes this year, many may have thought the opportunity to refinance their home mortgage to near record low mortgage rates would be gone. Well, they may have ‘another bite at the apple’.

I have been surprised during the last several years at how many believe it would not be worth their time or money to refinance. Some had mortgages a little below \$100,000, while others had current rates of 5.75% or higher. In my opinion, both warrant a close look with the likelihood of refinancing. In early June according to Bankrate.com, a fixed rate of 4.04% could be obtained for a 30 year mortgage, and lower rates could be possible. In this case, numbers do not lie; so, it is pretty easy to determine whether or not it would be worth the effort.

As an example, someone with a 5.75% mortgage, twelve years remaining, paying \$1,120 per month, and owing \$116,307.82 should consider refinancing. While a new rate of 4.04% is not two percent lower than the current rate, which is an old adage many follow, refinancing would be beneficial. Even by adding an estimated cost of \$3,000 to refinance, the new payment would be \$572.35. While many object to extending the mortgage back to a new 30 year period, I like to offer a solution to those who are disciplined. They should take the monthly savings between the old payment and the new, \$547.65 in this example, and invest it each and every month. Should the investment average 6.5% for the next twelve years, the account value could grow to \$112,444.17. This is even after taking into consideration paying commissions for assistance on the investments. After paying twelve years on the new mortgage, the payoff would be \$87,747.69.

The homeowner would have paid \$161,280 after twelve years of payments (144 X \$1,120), whether paying off the existing mortgage or refinancing. By keeping the existing mortgage, it is paid off at the end of the term, but that is all. By refinancing and investing the monthly savings without fail, the homeowner could also have the mortgage paid off, and possibly end up with a sizable investment account. Looking at the above numbers, the homeowner could take \$87,747.69 out of the investment balance to pay off the mortgage and still have \$24,696.48 available for other uses! Who wouldn't consider refinancing? If the investments were to do better, the benefit only increases.

Those of you who are encouraged to go and speak with your mortgage lender may hear different advice. Most may suggest a shorter term to “avoid” paying all that interest cost. Let's consider the results using the lower mortgage rate

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Insights Continued

(3.24%) for the shorter twelve year term. The new payment would be \$1,001.11 resulting in a savings of \$118.89 from the existing payment. Naturally at the end of the twelve years, the new mortgage would be paid off. But, would the investment account be worth more than the benefit when the 30 year mortgage is used? Using the same growth rate and reduction for commissions, the value would be \$24,411.26. While it is close, the flexibility using the 30 year mortgage is higher; and should the investments perform better than 6.5%, even slightly, the benefit would become larger than using the shorter term mortgage.

Those seeking initial financing on a new purchase face a similar decision, whether to opt for a fifteen year mortgage or one lasting thirty years. The same principle applies here. Since the longer term mortgage can still have a low rate which is locked for the entire term, taking the difference between the two mortgage payments and investing it will result in similar benefits to the example above. Taking the shorter mortgage only results in a paid for home at the end of the fifteen years. By taking the longer mortgage and investing the difference consistently, the investments could grow to a value higher than the corresponding mortgage balance after ten or more years. This results in the ability to spend the same amount of funds and yet be able to pay off the mortgage while still having funds left in the investment account.

To create net worth, it often requires more than just setting aside funds in investment accounts. Making smart decisions can also add to one's net worth over time.