When Should You Refinance Your Mortgage?

With interest rates on 30-year fixed rate mortgages now down a percentage point to about 10.25 percent since last March, many homeowners want to eliminate their current, more costly loans. In fact, the Federal National Mortgage Association expects refinancing to account for up to 20 percent of this year's new mortgage business.

But does refinancing really make sense now? To justify a new round of appraisal, loan origination, and closing costs, financial advisors may advise that you consider a new mortgage only if its rate is at least two points lower than the rate on your existing loan and you plan to stay in your home for two or more years. For most homeowners holding fixed rate mortgages, that means a rate below the average of 9.5 percent. Two notable exceptions: homeowners who took out their loans when rates hit their cyclical peak of 11.33 percent last year and those who never refinanced even higher rate mortgages from the early 1980s.

The decision is less clear-cut for homeowners with adjustable rate mortgages (ARMs), in part because of the way the rates are set. Most ARMs are pegged to1-year Treasuries (recently 7.99 percent), while 30-year fixed rate mortgages are indexed to 10-year notes (7.89 percent). Since short-term rates are expected to fall at least one-half of a percentage point more than long ones, rates on ARMs should drop further than those on fixed rate loans this year, reducing the temptation to refinance. But, if Treasury yields head back up later this year, as has been predicted, locking in a 9.5 percent rate during 1991 makes sense. The conclusion is that the longer you plan to stay in your home, the more attractive refinancing may look.

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