Should You Refinance Your Mortgage Now? Here's What You Need to Consider

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Your house might hold the key to getting some money in your pocket.

The number of people refinancing their mortgages is skyrocketing because interest rates are plummeting. The uptick began earlier in the year, before the COVID-19 crisis was a factor.

But because of coronavirus, many people have lost their jobs and the economy is struggling. Government intervention has driven interest rates even lower, further increasing the demand for refinancing.

"We're seeing a lot of activity in the refinance space, and as a matter of fact, our largest production days in the history of the company happened in March," says Bill Banfield, Executive Vice President of Capital Markets for Quicken Loans and mortgage platform Rocket Mortgage. "What we're seeing is predominantly rate and term refinances where people are looking to just lower their payments and get payment relief."

Loan applications doubled for Quicken in the first quarter of 2020 versus the same time period last year.

Digital lender Better.com has also seen a dramatic increase in mortgage applications, with a 399% increase in the last week of March over the same period a year ago.

"There's a million reasons why people want to refinance but the underlying theme is that people want to get into a better financial position," says Santi Roy, Head of Refinance at Better.com. "They want to get into a more secure position, whether that means to reduce the interest rate and save money per month or tap into their equity and take cash out, they want to get into a more solid place."

Different Types of Mortgage Refinancing

Borrowers have two ways of refinancing a mortgage: the traditional way and cash-out refinancing.

With a traditional refinance, borrowers rework their current mortgage terms, usually by adjusting interest rates or loan terms. This type of refinancing usually lowers the monthly mortgage payment.

In a cash-out refinance, people use some of the equity in their homes to get cash while changing the terms and the amount of the loan.

"In a cash-out, you're going to be getting money back from the bank." Roy says. "So you're adjusting your interest rate, but then you're also choosing to tap into the equity you've built up."

With this type of refinancing, you end up with cash and a new fixed-rate mortgage. Because of the fixed interest rate, Roy recommends homeowners who need cash to consider cash-out refinancing instead of a home equity line of credit, as HELOCs often have variable interest rates.

Better.com has seen a 150% increase in cash-out refinance applications from February to March of this year.

"I would imagine people are using it to have as emergency funds," Roy says. "People are using it to create more reserves and create more assets."

There are some limits to cash-out refinancing. For example, Banfield says the maximum mortgage amount on a cash-out mortgage is typically 80% of the property's value. So on a $400,000 property, the maximum cash-out mortgage is $320,000.

"If you did a regular refinance where you're just paying off the existing loan and getting a lower rate, you can [mortgage] up to 95% or 97% of the property value," he says.

Should You Consider Refinancing Your Mortgage?

The idea of paying less each month for housing can seem great, and refinancing could save you money. Banfield says people who took out a mortgage in the last couple of years could potentially drop their interest rate by three-quarters of a point if they refinance.

However, borrowers should consider more than just the potential for monthly savings when thinking about refinancing, including how long they plan to stay in the house.

Robert Paredes, a Tampa-based branch manager for Hometown Lenders, looks at the amount of the monthly savings combined with any costs involved to figure out how long it will take to break even to determine whether refinancing makes sense .

Using a $100,000 mortgage at a rate of 4.5%, Paredes says refinancing to 3.5% would save about $100 a month in payments. However, he says other costs involved in refinancing, like closing costs, appraisals and title searches, could total several thousand dollars.

Paredes says if a homeowner plans to stay in the house for several years, they will probably save money in the end by refinancing.

However, he advises against refinancing if you're considering selling your home in the near future, especially if the sale happens before you break even and see any savings.

People with unstable income might also want to think twice about refinancing. If you've lost a job or are furloughed, refinancing might be difficult.

"As a lender, when you underwrite the income of a borrower, you need to be able to determine whether or not that income is being received, if it's steady, and if you can rely upon it into the future," Banfield says. "So for the folks that have had their occupation disrupted, they're going to find it's going to be difficult to get a new mortgage at this time. But when they go back to work, they certainly would be able to look at that."

What the Mortgage Refinance Process Looks Like

The process for both traditional and cash-out refinancing is the same, and much of it can be done online, up until the closing. Some states require in-person closings, or at least in-person notary services. The requirements also depend on the lending company.

The key to saving the most money is speed. Rates are constantly changing and lenders are tightening their belts, so if you think refinancing is a good idea for you, get more information soon so you can act on it.

“I would always suggest that sooner rather than later talk to a loan officer and do some research to understand your situation and see what your options are,” Roy said.

Tiffani Sherman is a contributor to The Penny Hoarder.