

## The Pros and Cons of Mortgage Refinancing

Mortgage refinancing is a process in which a mortgage holder, usually a homeowner, takes out a new mortgage with better terms than the old mortgage. In the process, the mortgage holder pays off the old mortgage, essentially replacing one loan with another. If the new mortgage terms are chosen carefully, mortgage refinancing can be a valuable method of improving one's finances.

For instance, a lower interest rate is generally a sign that a mortgage is a good investment. In determining the total cost of any type of loan, the interest rate is the variable with the most weight, so a mortgage with a lower interest rate usually offers substantial savings. On the other hand, mortgages that offer a lower monthly payment without also offering a lower interest rate (for instance, loans that offset a higher interest rate by extending the term of the loan) have a higher total cost. Because this kind of loan can be ruinously expensive in the long run, it should be chosen only if the homeowner cannot make higher payments because of relatively short term financial difficulties, but knows he or she will be able to make higher payments soon.

Another consideration is whether there are "hidden" fees associated with either the new or the old mortgage. For example, it is common for a mortgage to have fine print that requires the holder to pay a penalty if the mortgage is paid off within a set time after taking out the loan. The penalty is designed to prevent the mortgage holder from closing the loan too early for the bank to make a decent profit. Most mortgages have a penalty of this type, but it rarely poses a problem. The penalty period is usually so short (for example, one year on a twenty to thirty year loan), that it is extremely uncommon for a mortgage holder to pay off the mortgage or get mortgage refinancing during the penalty period. However, a longer penalty period can be troublesome, and can effectively prevent a homeowner from getting mortgage refinancing during a period of exceptionally low interest rates. Because paying off the mortgage within the penalty period can be pricey, there may be no savings in taking out a new mortgage.

However, mortgage refinancing is a sound financial move if the first mortgage's penalty period has passed, interest rates are low, and fixed rate mortgages are available. Reading all the fine print, including the details the lender does not highlight, can lead to considerable savings. With some thought and care, mortgage refinancing can lead to increased financial stability and a bright financial outlook.

## About the Author

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