Workshop: Furthering Your Financial Wellness

Mortgages and Refinancing

Homeownership made possible. When it comes to buying a home, few people can buy one outright. For most of us, mortgages make the dream of owning a home a reality. This lesson will focus on mortgages, refinancing and reverse mortgages to help you better understand your financial options in homeownership.

Mortgages

Being smart about your mortgage is necessary for financial wellness, which leads back to the first lesson of this chapter: **only purchase a home you can afford.** A mortgage results in an agreement with a lender to pay for the cost of your house over a specific length of time, plus interest. Additionally, your house becomes collateral; if you miss payments, the lender can assume ownership of your house. This is called a foreclosure. Foreclosing on your house can have damaging effects on your credit, prevent you from buying a house for 3 to 7 years, and can result in many more expenses. It is important to do your research and choose a mortgage that is best for you. The most common types of mortgages include:

30-year fixed mortgage – The "conventional" mortgage, good for those planning to stay in their house long-term. Your interest rate is fixed at the time you purchase your home and remains the same for the life of the mortgage.

15-year fixed mortgage – This type of mortgage generally has lower interest rates than 30-year as you're expected to pay off the house sooner. 15-year mortgages help you to build equity faster, but your monthly payments will be higher than with a 30-year.

Adjustable rate mortgage (ARM) – This mortgage is also for a fixed time period, but you agree to an interest rate for the first several years, most commonly 5. After that point the interest rate becomes adjustable, depending on your lender and the market. ARMs are good for people not planning to reside in their house for long or those prepared to refinance. However, refinancing does not have to be an immediate action, depending on interest rates.

Refinancing—What is it?

Refinancing allows you to change the terms of your mortgage. Refinancing may be beneficial for those who:

- Have more than 20 percent equity in their homes.
- Are looking for an interest rate at least 1 percent lower than their current rate.
- Would like to pay off their mortgage sooner.

Refinancing may save you money, but could end up costing you more in some situations. For example, if you find a lower interest rate, but end up extending the length of your loan, you may pay more in interest over time than if you stayed with your previous rate and paid it off sooner.

Interest Rates Refresher

If you completed the Achieving Financial Wellness workshop, you should remember that interest rates are dependent upon your creditworthiness. Keeping track of your credit and ensuring a high score helps to keep your interest rates down. **The better your credit, the better your interest rate.** Be wary of mortgages that offer variable rates; they can fluctuate often and result in unnecessary costs.

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Reverse Mortgages

Reverse mortgages are exactly what the name implies--rather than you paying your mortgage, the lender pays you money for the home while you still live in it. The amount you pay depends on the amount of equity you have in the house. You or the youngest person on the mortgage must be at least 62 years old to qualify. Reasons why people consider reverse mortgages include:

- They're juggling high medical bills
- They have high home repair costs
- They want to supplement their income

Proceed with caution. There are many considerations to be made when contemplating a reverse mortgage. It may be nice to be paid, but it will come at a cost.

- You'll lose the equity in your home.
- You may experience more charges and service fees to maintain the loan.
- The lender is paying you from the money that you have already paid on your home. Each time you are paid, the amount you will owe on your home grows.
- Your interest is no longer tax deductible.
- Your interest rates are variable and change depending on the market.

While there are many checks and balances to help protect you from fraudulent practices, it is beneficial to shop smart and be wary of scammers. Some reverse mortgage salespeople will do their best to sell you on a loan to make commission, so make sure to do your research and find what will work best for your situation rather than just agreeing to a sales pitch.

Sources

1. foxbusiness.com. Mortgages 101: What You Need to Know. 2013
2. trulia.com. The Basics of Refinancing Your Mortgage. 2012.
3. consumer.ftc.gov. Reverse Mortgages. 2015.

Next Steps

1. Take Chapter 1 Quiz

