

## THE IMPERATIVE OF MORTGAGE REFINANCING

**M**ortgage refinancing is a high impact activity with spiral effect on increased housing development, house affordability, and job creation. The recent launch of the Nigerian Mortgage Refinance Company (NMRC) is premised on this consciousness. Clearly it is seen as another bold step by the government aimed at addressing the challenges of providing good and affordable houses in Nigeria.

NMRC is coming in as an integral part of the country's financial system. The activity of the organization will give fillip and deepen the financial market, particularly the mortgage segment. The company, which sits as a financial intermediary between the Nigerian capital market and mortgage financial institutions that provide mortgage loans to average working Nigerian citizens, portends new hope for low-income earners who currently cannot afford the cost of a mortgage loan. Besides, the primary mortgage institutions, who are currently hamstrung with illiquidity will have a leverage for boosted performance in housing delivery. But this will depend largely on the type and structure of refinancing to be implemented by the NMRC. Also, the peculiar need of the market will equally constitute a factor.

The refinancing of an existing mortgage could be either for the purpose of changing the interest and/or term of a mortgage without advancing new money on the loan. This differs from a cash-out refinance, in which new money is advanced on the loan. Rate and term refinances can carry lower interest rates than cash-out refinances.

Rate and term refinancing activity is driven primarily by a drop in interest rates, while cash-out refinance activity is driven by increasing home values. Because there are pros and cons associated with a rate and term and cash-out refinancing, the borrower must weigh the pros and cons of each before making any final decisions.

Refinancing a mortgage at a lower interest rate is not always the right decision. Instead, it's good to put some thought behind the timing of refinancing decision. Refinancing a mortgage many times over has the tendency to reduce the overall financial benefit. The reason being that continuous migration to the next low mortgage rate comes with a price by leaving a trail of closing costs.

Mortgage refinancing must be pegged on clearly defined goals before deciding on it. There is need to determine what needs to be accomplished by that choice. Remember, refinancing a mortgage does not pay off the debt; it just restructures it, often at a lower interest rate and a different loan term than the current mortgage.

### GOALS OF MORTGATE REFINANCING

Reducing the interest expense is the most common goal of a refinance. But some homeowners also appreciate the ability to extend the loan back out to a much longer period say 30 years, thereby reducing the monthly payment.

Debt consolidation is another goal of refinancing. If you have both a first mortgage and a home equity loan, combining the two mortgages into one fixed-rate mortgage levels out the payment over the loan term.

Many homeowners refinance because they want to get out of (or into) an adjustable-rate mortgage (ARM). In high interest rate environments, homeowners are attracted to ARMs because they typically are at a much lower interest rate than a 30-year fixed-rate mortgage.

On the other hand, in low interest rate environments, the differential between the fixed-rate and the ARM may not be so much, and homeowners like the security of locking in a fixed rate over the mortgage term.

Fundamentally, the timing of the mortgage refinance is important. After clarifying the reasons for refinancing a mortgage, there is need to consider whether the timing and circumstances make this the right time to get a new loan.

Usually, you have to plan to hold the property for a while for refinancing to make sense. You have to look at the savings relative to the cost, and then consider: How long you can hold it.

Another issue of importance in mortgage refinance is the closing cost associated with it. When weighing whether to

### MARKET UPDATE

	15/01/13	15/12/13	15/01/14
Naira/US\$	154.1	155.2	155.75
Brent,US\$/BBL	109.78	107.84	109.9
COCOA, US\$	1487.82	2685.47	2760.56
MPR%	12.00	12.00	12.00
INFLATION RATE %	10.3	7.9	8.0
MORTGAGE RATE %	22.0	23.0	23.0

### STOCKS CONSTITUTING GMA INDEX

STOCKS	31/12/13 Price (N)	15/01/14 Price (N)	%Change in Price
OANDO	24.25	19.20	-19.50
GTBANK	27.02	23.67	-12.40
OKOMU	44.00	38.40	-12.73
STANBIC	21.35	19.05	-8.67
DANGSUGAR	11.70	10.74	-8.21
FIDSON	2.79	2.80	0.36
TRANSCORP	4.35	3.66	-15.86
CCNN	11.75	8.00	-31.91

	PRICE (N)	NAV (N)
	31/01/14	21/02/14
UHOREIT	50.00	55.58
UPDCREIT	10.00	10.17

Index	31/12/13	21/02/14	% Change
NSE ASI	41,329.19	38,295.74	-7.34
GMA Index	1.50	1.31	-12.75

Source: CBN, DMO and NSE

refinance, property dealers and homeowners typically are urged to consider how many months of lower payments it will take to recoup the closing costs of the new mortgage.

### YOUR CURRENT STANDING

Before opting for refinance, it is important to know clearly where you stand with your current mortgage -- including the loan terms and interest rate, as well as relevant factors such as your credit standing and whether or not the loan has a prepayment penalty. For example, if your monthly payment goes down by N25,000, it would take 24 months of lower payments to recoup the average closing costs.

### REFINANCING COSTS

It should be noted that a lower interest rate with extended mortgage term, ends up with more spending in interest. For example, replacing a mortgage that has 20 years remaining with a 30-year mortgage will result in higher interest expense over the life of the new loan.

While this is not a bad rule of thumb, it does not really measure your savings. Savings come from a lower interest expense, not lower monthly mortgage payments.

To figure out whether refinancing with a loan term extension will result in increased savings, all one need is do two calculations: one where the new loan has the same term as the old loan, and

one where the new loan is the length of your planned refinance. Compare the interest savings to see if refinancing accomplishes your financial goal.

Some people refinance simply to make the monthly mortgage payment more affordable. A lower interest rate and/or a longer loan term both work toward lowering the monthly payment. As long as the homeowners understand they may not be minimizing total interest expense, affordability can be a motivation for extending the loan term.

While short-term savings are important, they are not the only factor to weigh when considering a refinance. Refinancing to get out of an ARM, interest-only mortgage or other onerous mortgage provisions may be reason enough to take on a refinancing.

However, in some cases, homeowners with ARMs would be fine sticking with their loan, especially if they do not plan on being in the loan long term and the reset rate on their mortgage is not financially threatening.

If the intention is not to hold the property for very long, then it may be right to stay on the current mortgage. Here, the number of months it takes to recoup closing costs becomes the more important calculation done by the refinancing calculator.

### TYPES OF REFINANCING

The two major types of refinances are cash-out refinancing and standard "plain vanilla" refinancing, where you are just refinancing the existing mortgage balance.

In a cash-out refinancing, you take out a new mortgage on the same property in which the amount borrowed is greater than the amount of the previous mortgage. The difference is taken out in cash.

A cash-out refinance will typically have a slightly higher interest rate than a plain vanilla refinance because the lender has more money at risk. Cash-out refinances often are used to pay down debt, but this type of mortgage has both pros and cons.

For example, with a cash-out refinance that pays off debt, on the pro side, interest rate is reduced on the debt, while lines of credit on other liabilities are freed up.

On the con side, higher interest expense may be incurred because a longer term, say 30 years may be taken to pay off the balance transferred from existing liabilities to the mortgage. There is also the risk of running the balances back up on debts and not being able to make the payments.

### TIDYING UP THE BOOKS

It is imperative that the firm's credit history and credit rating is set in the best possible shape. This will help and make for a better mortgage rate. By regularly reviewing credit reports and getting copies of credit rating as well will enhance the chances of very good mortgage deals.

It must be noted that the biggest risk in this scenario is in converting an unsecured debt into a secured debt. A few misses on mortgage payments can lead to a foreclosure of the property.

On the other hand, a plain vanilla refinancing is intended to replace existing mortgage with a new one at a lower rate. There is no cash out, unless it is to cover closing costs.

One advantage of a plain-vanilla refinancing is that it usually offers a slightly lower interest rate than a cash-out refinancing. Another major plus of this type of refinancing is that outstanding mortgage debts are not significantly increased.

It must be noted, however, that in cash-out refinancing, a mortgage can be more appropriate to accomplishing certain goals, such as paying off debt.

### MANAGING COSTS

While a refinance can help harvest more cash, it is equally important to watch out for costs that eat into those savings. Accordingly, it must be recognized that there is no such thing as a free lunch, and there is no such thing as a "no closing cost" mortgage. The originating lender will get paid for its efforts; it is just a matter of how they get paid. Closing costs can be paid in origination points, a higher interest rate or a higher loan amount.

Points come in two flavors, discount and origination. Discount points allow the borrower to prepay interest expense upfront and buy down the nominal or stated rate on the mortgage loan. The points paid are, however, considered in calculating the annual percentage rate, or APR, on the loan.

It must not be forgotten that other expenses, such as private mortgage insurance (PMI) can impact on the mortgage. When the loan-to-value ratio is more than 80 percent of the appraised value of the home, the first mortgage lender will want to transfer the payment of the PMI to the mortgage holder. That adds to the cost of the refinancing. In essence, avoiding unnecessary or junk fees can keep down your closing costs and improve the return when refinancing a mortgage.

Refinancing becomes much acceptable in a low interest rate regime, added to a friendly government program such as the NMRC that makes it easier to refinance loans.

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