No-Cost Refinancing Can Make Lots of Cents

Some homeowners have gotten a little giddy about the steady downward trend in mortgage interest rates, refinancing multiple times to catch every last tiny drop.

Lenders have responded to this surge by offering no-cost refinancing- no points, no closing costs. You sign the papers and walk out with a lower interest rate than you have now.

But of course, the lender is going to make money somewhere on the deal. The trade off for the homeowner is an above-market interest rate, generally about a half to three quarters of a percentage point, according to HSH Associates, a mortgage-information firm.

Do you come out ahead this way? It depends. With a 30-year mortgage, if the difference between a no-cost refinance and the market rate is three-quarters of a percentage point, take the no-cost mortgage if you expect to be in your house for less than five years, or if you think rates will fall enough to make refinancing worthwhile again during that time.

The higher the interest rate on the no-cost option and the higher monthly mortgage payments will be more than offset by the money saved on closing costs and points, assuming closing costs and points come to three percent of the mortgage amount.

For example, the average rate nationally on a fixed, 30 year mortgage is about 6.75 percent. Countrywide Funding, the nation’s largest mortgage lender, is offering mortgages at that rate with 1.3 points. But it also offers a no-cost option at 7.625 percent- a little more than three-quarters of a point higher.

Nation’s Bank, another big national lender, offers a 30-year fixed rate of 6.75 percent with one point. Its no-cost mortgage has a rate of 7.87 percent. If you refinanced a $110,000 mortgage at 6.75 percent and paid all of the closing costs yourself- say $3,300- your monthly principal and interest payment would be $713.

If the lender absorbed the entire $3,300 in closing costs and charged you an interest rate of 7.625, your monthly payments would rise to $778. That means you would pay $65 a month more on your mortgage each month in exchange for the lender picking up the $3,300 in closing costs. You would be ahead on this deal for about four years.

With a 15-year mortgage, the no-cost mortgage is better. It takes about six years in this scenario before the higher monthly payments exceed the benefit of no closings costs. And the no-cost mortgage becomes more attractive if closing costs in your area exceed three percent or if the spread between the no-cost mortgage and the market rate mortgage is less than three-quarters of a point.

If you're a tax accountant, you might want to figure in the interest you could earn on that $3,300 you didn't pay in closing costs, plus the extra mortgage interest deductions you get on the higher monthly payment. Both work to the advantage of the no-cost option.