Consumer Facts for Older Americans

What You Should Know About Refinancing

What is Refinancing?

Refinancing is a process in which you pay off one or more existing debts with a new home loan. If you have perfect credit, refinancing is sometimes a good way to obtain a lower interest rate or to convert a variable rate loan to a fixed rate. However, if you are in the midst of financial difficulties, if you have too much debt, or if you have bad credit, refinancing is loaded with pitfalls. We recommend that you be very careful when refinancing debts. Many refinancing loans hurt consumer. Here are twelve things to consider before refinancing.

Twelve Refinancing Rules

1. **When in doubt, do not refinance or consolidate debts.** Caution is always a good idea. Refinancing usually involves significant costs.
2. **Do not refinance because of pressures from debt collectors.** Debt collectors may try to scare you into refinancing because they have no other way to get their money. There are better ways to address debt collection problems than to borrow against your home.
3. **Never (or almost never) use your house as collateral to refinance unsecured debts such as credit card debts, medical debts, or utility bills.** If you have financial problems, unsecured creditors can rarely take your property for nonpayment. But if you refinance and use your home as collateral, the lender can take your home.
4. **If you have an existing debt with a finance company or high-rate second mortgage lender, do not refinance that debt with the same company.** You can ask the company to agree to lower payments on the existing loan, but you should not allow the creditor to write out a new loan, which is likely to involve hidden penalties and expensive new closing costs (or a higher interest rate).
5. **You should not turn a car loan into a second mortgage unless you would rather lose your home than your car.** Repossession is bad, but foreclosure is worse.
6. **Do not refinance low interest-rate loans with higher rate loans.** Make sure that the "APR" (Annual Percentage Rate) of the new loan is lower than the interest rate stated in the note on the old loan. (The APR adjusts for certain up-front fees in the old loan which you have already paid.) Also factor in the cost of insurance, closing costs, and other up-front fees. Treat these as costs of the new loan that could be avoided if you did not refinance. Note: These cautions apply even if your monthly payment is lower.
7. **Keep long-term first mortgages unless you are getting a lower rate.** Lenders may try to consolidate (pay off) a first mortgage. That is, they may try to give you a new mortgage equal to the old mortgage plus the new loan. Do not let the lender do this unless the interest rate on the new loan is significantly lower than the old first mortgage to offset prepayment penalties and fees and charges and if the mortgage is

for the same length of time.

8. **Be careful about variable rates.** Variable rate refinancing loans can be very tricky. In any variable rate transaction, the monthly payment can increase drastically when you can least afford it. And some loans have artificially low rates (and payments) during the first months.

9. **Do not refinance loans when you have a valid legal reason for not paying that debt.** If you have a legal defense to repayment of a debt, such as lender fraud, you can raise that defense in court. If you refinance with a new lender, the defense may not be available against the new creditor. If you need legal help to determine whether you have a defense, you should get that help before entering the refinancing deal.

10. **Be wary of claims that you will get a tax advantage from a debt consolidation loan.** Many lenders offering bad refinancing deals talk about the benefit of the tax deductibility of mortgage interest. Make sure you understand how your personal tax situation will be affected. (For example, if you don't itemize deductions, the tax deductibility of mortgage interest is worthless.)

11. **Some refinancing deals are scams. When in doubt, seek help to review the loan papers before signing anything. You can walk away from a bad deal even at the last minute.** When in doubt, seek help to review the loan papers before signing anything. You can walk away from a bad deal even at the last minute. Refinancing involves great potential for hidden costs, fees, security interests and other unfair loan terms. Even some reputable lenders make unfair refinancing deals. Whenever possible, ask a qualified professional to review the refinancing paperwork before you sign.

12. **If your home is collateral in a refinancing deal, remember that you have three days to cancel.** When you use your home as collateral for a refinancing transaction, federal law usually gives you the right to cancel for three days. You can cancel for any reason. If you do change your mind, make sure to cancel in writing before the deadline. The lender is required to give you a form for this purpose. Even if the lender does not give you the appropriate form, you may cancel by sending a signed, dated letter to the lender indicating your desire to cancel the refinancing.

Reverse mortgages are available as a refinancing option for older homeowners who have built up substantial equity in their property. A complete discussion of reverse mortgages is included in another Consumer Concerns and Consumer Facts.

For More Information…

More detailed information on refinancing and other consumer credit issues is contained in *Surviving Debt: A Guide for Consumers*. The handbook is available from the National Consumer Law Center, 77 Summer Street, 10th Floor, Boston, MA 02110 (617/542-9595).

February 2006

This brochure was supported, in part, by a grant, number 90-AP-2647 from the Administration on Aging, Department of Health and Human Services, Washington, D.C. 20201. Grantees undertaking projects under government sponsorship are encouraged to express freely their findings and conclusions. Points of views or opinions do not, therefore, necessarily represent official Administration on Aging policy.