Aol Real Estate.

Secrets to Refinancing

Aol ORIGINAL

| By Sheree R. Curry | Posted Mar 7th 2011 2:10PM

Want to refinance your home loan, but you're afraid you might not qualify for the best terms? Perhaps you think your credit score isn't good enough, or the equity in your house is too low, or your debt ratio is out of whack. Well, although all of that could be true, you just won't know wallowing in the shadows. Chances are you might have a better chance than you think if you understand a few of the secrets to refinancing.

Know Your Credit Score

"I had a woman tell me her credit was 'terrible' and it turned out she had a 741 mid score, qualifying her for the best terms," says Jay Dacey, a mortgage planner in the Twin Cities.

Many people guess at their credit score rather than take the time to discover it. A credit score, generated from data on a credit report that details items such as a person's history of payment punctuality, the total amount of available credit, the total amount and type of debt, the number of open and active accounts, and the longevity of relationships with creditors.

The major consumer characteristic contributing to a VantageScore credit score is one's payment history. Since it makes up approximately 32 percent of the score, it is beneficial to refinancing to make payments on outstanding debts to avoid a negative ding on your credit report.

Know Your Home's Value-to-Equity

Linda Mager, who had Dacey find her a low mortgage rate in September, more than likely boosted her score after her refinance. Mager, who has more than 30 years experience working as a closing agent at a title company knew that with current low interest rates, it would be a good time to refinance her two-story home in Mendota Heights, Minn., a suburb of St. Paul, but she also needed to shed some other debt.

"A 4.375 interest rate is what drove us to refinance," she said. "The only thing we would lose was the five years we had paid down on the current mortgage, but if I make extra principal payments it was a no brainer. Even paying $100 extra bucks a month [toward principal] makes a huge difference."

Mager's only concern was that the value in her home she purchased 20 years ago for $240,000 had declined since the last time she refinanced five years ago, but because she also had been making extra payments to the principal, shaving off thousands in interest, she still had grown her equity. In fact, she still had enough equity to pull out extra money to pay off some other bills, without depleting all of the equity in her home.

Although many experts will tell you to not pay off unsecured debt, such as credit card debt, with the secured debt in your home, Mager says this option worked for her because her monthly payments are not increasing and she still has sizable equity.

Know Your Mortgage Terms

When you go to refinance an original 30-year mortgage, say after 5 or 7 years of living in your home, you do run the risk of adding to the overall amount of money that you will owe a bank, even if you reduce your monthly payments. That's because banks don't typically give out 25-year or 22-year mortgages. When you refinance to a fixed-year rate, think 15-year or 30-year as your options.

Mager could've dropped down to a 15-year mortgage but decided that by opting for another 30-year she can afford to make extra payments to pay off the 30-year faster while still having wiggle room to meet monthly payments should, heaven forbid, she lose her job or one day has unexpected bills.

While a 30-year will typically mean lower monthly payments, a 15-year -- especially if you are not taking cash out -- would mean paying down your loan faster, and ergo, you're paying less interest. At the same time, Mager's strategy is if you can afford larger monthly payments, why not just opt for the lower fixed rate and still kick in extra payments each month. The equivalent of an extra mortgage payment a year is said to knock off almost a year's worth of interest.

So if you can't refinance right now, try making an extra payment or two toward your mortgage. This will go a long way to increasing your equity to help you qualify a couple of years from now, assuming home prices at least remain steady.

Reduce Credit Card Debt

Another way to increase your chances of being able to refinance is reducing your credit card debt ratio to available credit. You can make double payments here, too, to reduce your balance faster, but also don't close any open accounts.

"Opening and closing new credit can drop a score up to 60 points for a year. The higher the score the more it will drop. It can hurt your credit for one to two years," says Tracy Becker, president and founder of North Shore Advisory, Inc., a New York -based credit restoration company.

Say you have $4,000 on a credit card with a $5,000 limit and that's your only card. Well, then you're almost maxed out of your available credit with 90 percent of it used, a scenario that would hurt your credit score and thus your chances to refinance.

"If the balance is over 10 percent of the limit the score will begin to drop. The closer the balance is to the limit the more the drop," says Becker. "If the balance is over the limit even by $1, the score can drop over 100 points."

But if you have three other unused cards, each also with a $5,000 limit and no balances, now out of $20,000 of available credit, you're only using $4,000, or 20 percent of your available credit, and that's a pretty good position to be in so long as you ar at least paying the minimum each month.

Experian, which generates credit reports, recently released data showing that the average person still owed more than $4,200 on credit cards at the end of 2010 and that the average number of bank cards that consumers hold has dropped (nearly 23 percent since 2007) to 1.97 cards. As a result, cardholders are utilizing, on average, more than 30 percent of their total available bank card balance, which is a nearly 10 percent jump since 2007. These high balances impacts utilization rates, which account for approximately 23 percent of a consumer's VantageScore.

"We want consumers to understand that overspending can often have broader implications to their overall fiscal fitness," said Maxine Sweet, vice president of public education at Experian. "It's important for consumers to get that debt under control before it has a lasting impact on their credit scores."

If you're looking to refinance soon, then opening new accounts will only hurt your score as each new inquiry by a third-party can drop it five points. But if you're trying to rebuild your score for a couple of years from now, go ahead and open up a new credit card, just don't use it.

Bring Money to the Table

One way to help you refinance now is to being money to the table through a method known as cash-in refinance. As we reported earlier in "As Refinancing Declines, Cash in Refis Rise," Richard Shin, a Queens, NY attorney with good credit and great income was turned down by his original lender when he wanted to refinance his 30-year-fixed rate mortgage on his single family brick home to a 15-year-mortgage with a lower interest rate. Another lender finally approved him for a $499,900 loan on his $1.15 million-appraised home after Shin agreed to bring $60,000 to the table to help bridge the gap to pay off his old $560,000 mortgage.

So even when you might think all hope is lost for your refinance, it just may not be.

"Quite a few of my clients are what I call 'reluctant referrals,'" says Dacey about the people who can't see through all the negative news out there and think they are stuck. The only thing holding people back is their willingness to pick up the phone and talk to an experienced mortgage broker who has access to multiple banks' product offerings.

"If I can understand their situation there is a good chance I can help them. No mortgage broker will bat a thousand, but there are a lot of options for a lot of people," he told AOL Real Estate.