Should you refinance at a higher interest rate?

Reasons why refinancing with a higher rate might make sense

People typically think about refinancing when current interest rates are lower than the rate on their mortgages. A lower interest rate might help them reduce their monthly payments or save money on interest over the life of the loan.

There are times when refinancing at a higher interest rate might make sense however. Here are six scenarios when you might consider a higher rate when you refinance.

Refinance to pay off high interest debt

If you have a lot of high interest debt, getting a cash out refinance at a higher interest rate than your current mortgage rate might make sense. With a cash out refinance, you replace your current mortgage with a new mortgage for a higher amount and get the difference in cash at closing. You use this cash to pay off high interest debts and consolidate your debt payments into one monthly bill.

Credit cards and certain other kinds of debt can have interest rates that are significantly higher than the typical interest rates on mortgages. So paying a higher interest rate on a mortgage refinance might be a good financial decision if that higher rate is still lower than the interest rates on your other debts. Look at the potential savings in interest payments, and be sure to include the closing costs you might need to pay for a refinance, before you make a decision.

Refinance to pay for home improvements or education

Choosing a cash out refinance at a higher interest rate may also be a good idea when you need money for important investments. When you need cash to pay for home improvements or repairs that might increase the value of your home, then it may make sense to accept a higher rate. Getting money to pay for an education that might help you or your children improve your employment opportunities is also a reason to consider refinancing at a higher interest rate.

Refinance to stop paying mortgage insurance premiums (MIP)

If you have a mortgage backed by the Federal Housing Administration (also known as an FHA loan) you may need to refinance to stop paying the mortgage insurance premiums (MIP). For newer FHA loans, you may have to pay mortgage insurance premiums for 11 years or you may have to pay them for the full life of the loan, depending on the amount of your down payment.

Refinancing from an FHA to a conventional loan can help you stop paying mortgage insurance premiums. Look at the costs of refinancing at a higher interest rate, and the closing costs you might have to pay, versus the potential savings in mortgage insurance premiums before you make your decision. Keep in mind that you need at least 20% equity in your home when you get a conventional loan or you will be required to pay for private mortgage insurance.

Some people think about refinancing to remove the private mortgage insurance (PMI) that comes with many conventional loans. Refinancing is often not required to stop paying PMI however. You can request your lender remove PMI payments from your mortgage bill once your home equity reaches 20%. And lenders are required to remove PMI once your home equity reaches 22%.

Refinance from an adjustable to a fixed rate mortgage

When you have an adjustable rate mortgage, your monthly interest payments can change over time. When you have a fixed rate mortgage, your monthly interest payments will stay the same over the life of the loan. Some people value the peace of mind that comes with knowing their interest payments won't change. You can refinance to switch from an adjustable rate to a fixed rate mortgage, and your interest rate might be higher when you do.

Refinance to shorten the term of the loan

People think about refinancing to shorten the term of their loan and save money on interest payments. Generally speaking, the faster you pay off a loan, the more money you might save. Refinancing is one way to shorten the term of your loan. Keep in mind that refinancing is often not necessary to pay off your mortgage quicker. You can also make extra mortgage payments. Check the terms of your mortgage to see if it has a pre-payment penalty before you make extra payments.

Refinance to remove a borrower from a mortgage

Sometimes refinancing is the only way to remove a borrower from a mortgage. For example, after a divorce it may make sense to remove a former spouse from the mortgage for a house by refinancing. You may need to accept a higher interest rate to do this if current rates are higher than the rate on your existing mortgage.

Interest rates are on the move. Would you like to talk to us about a refinance or cash out refinance on your home? Get started today or call our friendly Loan Advisors at 877-220-5533.

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