

The following question regarding mortgage loan refinancing came from an FIL 360 student e-mail a few years ago; my reply follows.

*Does your bank just go along with it when you want to refinance your mortgage loan to get a lower interest rate? Aren't they unhappy to be losing the high interest rate they were earning?*

As long as your credit is ok and other documents check out (for example, you have not given someone else an interest in your property) you generally can refinance, and yes your bank goes along with it. They may be unhappy to lose a high interest rate, but through state laws and practices in the secondary mortgage market (Fannie Mae and Freddie Mac) there typically are no direct prepayment penalties on home mortgage loans. So your bank usually does not have a choice; you can pay off your existing loan (like with money from a new, lower-rate loan) any time you want. (The only effective cost of refinancing is that you have to pay a considerable amount in fees to get the new loan.) So if rates today are somewhat lower than your current contract rate and you expect to stay in the house for at least a few years you might well realize a positive Net Present Value by refinancing. NPV is positive when the PV of the savings stream from making smaller monthly payments exceeds the out-of-pocket costs of getting the new loan.

Your bank surely is not happy to lose an existing loan on which they are earning a high interest rate, but that does not stop you from refinancing. Think of these possibilities:

- 1) The bank you ask about refinancing at a lower rate is not the bank where you got the existing loan. This bank does not care that your earlier bank (their competitor) will have to lend the principal they get paid back at the new lower rate.
- 2) The bank you ask about refinancing at a lower rate is the same bank where you got the existing loan, but they already sold your existing note into the secondary mortgage market. They are not hurt by your replacing the high rate loan with a low rate loan, and they are happy to earn a fee for doing the paper work on the new loan.
- 3) The bank you ask about refinancing at a lower rate is the same bank where you got the existing loan, and they wish you would leave the high rate loan in place. But they know you can always pay them back early with a loan you get someplace, so you might as well get the replacement loan from them so at least they get to earn the fee for doing the paper work on the new loan. •