

RE 611 / Fin 611 – Real Estate Finance

Homework 7 – Refinancing Analysis

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- 1) Ralph's existing mortgage has an interest rate of 6 percent and an outstanding balance of \$179,950.43. His currently monthly payment on this loan is \$1,088.19. Ralph expects to move in 12 months, but needs some extra cash until then.

He has been offered a new, interest-only loan at 5.375 percent. The closing costs will be \$2,827.98, which will be rolled into the loan. In addition, the lender has offered to roll real estate taxes of \$642.59 and a \$79.00 tax service fee into the loan balance.¹

His new loan balance will be \$183,500.00, with a monthly payment of \$821.93 (\$266.26 less than his current monthly payment).

The mortgage broker claimed that the payback on the closing costs associated with this loan was 10.62 months ($\$2,827.98 \div \266.26), implying that even with a 12-month holding period this is a good move for Ralph.

Evaluate the mortgage broker's analysis. Is this really a good deal for the borrower? Why or why not? Provide calculations to support your conclusions.

¹ The tax service fee is an up-front charge for putting the borrower's property tax payments into escrow for the borrower. This is done so that the lender can be certain that the property taxes are paid when due. In this case, the borrower had previously been paying his property taxes on his own.