



The Dos and Don'ts of Refinancing

Refinancing is a process in which you pay off one or more existing debts with a new loan. It is sometimes suggested for people with financial problems to address their difficulties.

We recommend that you be very careful when refinancing debts. Refinancing an affordable amount of debt is one of the most tempting but risky steps you can take when you have financial problems. Many refinancing loans will hurt you more than they help

The attraction to refinancing is that it seems to resolve your financial problems even though your income and expenses do not change. The stroke of a pen pays off creditors that have been threatening action against you. After refinancing you only have to make one payment to a new creditor who is not (yet) threatening anything.

The disadvantages of refinancing are often hidden. Problems occur because of the complex mathematics which sometimes govern the refinancing process, including hidden fees and costs, and because the new loan may give creditors new ways to force payment and seize your property that were unavailable under the prior loan.

There are even times when a refinancing deal is nothing more than a scam to steal your home or other property. Each potential refinancing deal must be reviewed carefully on its merits. Use the services of a counseling agency to discuss the details of any loan you might be considering.

When in doubt, do not refinance or consolidate debts

Refinancing deals almost always come with significant costs. These costs will usually make matters worse in the long run.

Do not let debt collectors pressure you into refinancing

Debt collectors may try to pressure you into refinancing because they have no other way of getting their money. There are better ways to address debt collectors who are harassing you.

Never refinance unsecured debt into secured debt.

For example, do not take out a mortgage on your home to pay off credit card or medical bills. Unsecured creditors rarely can do anything to seriously hurt you if you fail to pay. By trading in such a loan for a mortgage loan you face the loss of your home if you continue to have financial problems. Do not refinance unsecured debt even if this allows you to lower the interest rate you are paying.

Do not refinance utility debts

Work something out with the utility company instead; most utility companies have flexible repayment plans. Even if this is unavailable it will almost always be cheaper to get the utility turned back on than it will be to pay the refinanced debt.

If you have an existing debt with a finance company or a high rate second mortgage company, do not refinance that debt with the same company

Ask the company to lower the payments on the existing loan, but do not allow the creditor to refinance that loan, which may involve prepayment penalties, new closing costs, and perhaps even a higher interest rate. Never allow the company to add new security – such as your home.

Do not turn your car loan into a second mortgage unless you would rather lose your home than your car.

Repossession is bad, but foreclosure is worst

Do not refinance a loan with household goods into a second mortgage

Not only is your home worth more than your household goods, but also it is very hard for a lender to repossess your household goods.

Do not refinance low interest with higher interest loans

The APR (annual percentage rate) of the new loan must be lower than the stated interest rate of the old loan, that is the rate stated in the note, or you will be losing money. You have already paid for certain up-front fees (and also insurance, closing costs, and other up front fees not treated as interest) The new loan must be cheaper than the old loan after those fees have been paid off.

Do not include your long-term first mortgage in a refinancing package.

Do not let second mortgage lenders pay off your first mortgage and give you a new mortgage equal to the first mortgage plus the new loan amount. The only exception would to offset prepayment penalties and fees and charges, and if (1) the new mortgage is for the equivalent length of time, and (2) the interest rate is significantly lower than the first mortgage.

Do not refinance loans when you have a valid legal reason not to pay that debt.

If you have a legal defense to the repayment of a debt, you can raise that defense in court. If you refinance with a new lender, the defense will not be available against the new creditor. You should get legal help to see if you have a valid defense before entering the refinancing deal.

Watch out for scam refinancing companies

Refinancing involves a great potential for hidden costs, fees, even hidden collateral, and other unfair loan terms. Even some reputable lenders make unfair refinancing deals. When in doubt, get help in reviewing the loan before you sign anything. You can walk away from a bad deal even at the last minute. A lender that is not willing to let you get outside help should not be trusted. Another way to avoid scams is never let a contractor or salesperson arrange financing for you and be wary of mortgage brokers. Unfortunately many brokers find refinancing deals which involve big commissions for them rather than good loans in your best interest.