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Refinancing your Mortgage

One way to reduce mortgage payments or to take “cash out” to pay for repairs or other expenses is to refinance your home mortgage. When interest rates are going down, refinancing can reduce monthly payments or allow a homeowner to pay off the mortgage faster. When interest rates go up, refinancing will usually increase the mortgage payments, because a big part of what you pay back to the bank is interest on the remaining principal amount (original sum) of your loan. Most of your payments for the first few years go towards interest.

A "cash-out refinance" lets the homeowner take extra money from the loan to pay for expensive repairs, pay off high-interest debts like taxes, car loans, credit cards, or even education costs. However, this also increases the amount owed on the loan and usually makes the monthly mortgage payments higher. Using the house as security/collateral for the loan puts the house at risk, so refinancing to pay off credit cards, for example, may not be a smart move.

Bank Requirements for Refinancing

Since mortgage lending procedures are more regulated now than decades ago, lenders are looking more closely at the borrower’s credit score, payment history, and debt to income ratio before approving any mortgage; including refinancing an existing mortgage. For instance, if any mortgage payments have been missed in the prior year, income has declined, a borrower has filed bankruptcy or has any unpaid court judgments (for money, foreclosure, repossession etc.), has excessive outstanding debt, or doesn’t have much equity (loan v home value) in the property the bank may refuse to refinance the mortgage.

Not all lenders have the same rules for loans, so it's a good idea to compare different options. When refinancing, there is no down payment required, but there are closing costs like appraisals and title insurance, which may be added to the new loan amount. The homeowner will need to apply and go through a credit check.

Post Divorce Refinancing

In divorce agreements, when one spouse gets to keep the marital home, it's common for the spouse who stays in the home to refinance the mortgage. This is done to remove the other spouse's name from the mortgage. Even if the court orders it, the bank is not required to refinance the loan and remove one of the borrowers from the mortgage. Lenders will look at the same factors: credit score, payment history, income to debt or loan ratio, etc. to approve a refinance to remove a borrower from the account.

If the spouse who wants to keep the house cannot refinance, some divorce judgments require that the house be sold, and proceeds be divided. Getting a cosigner for the refinanced loan may help a borrower. Staying on a mortgage on a house you no longer live in or own (quit claiming the deed doesn't change the mortgage) can make it harder for the spouse who leaves to get a mortgage for another home. It can also hurt their credit if the payments aren't made.

Alternatives to Refinancing

Other ways to reduce payments, cut expenses, or get financing for repairs include:

1. Low or no interest home repair grants and loans from local community development organizations; some are available to homeowners with moderate incomes, allowing them to have little or no monthly payments until the house is refinanced or sold.
2. Contractor financing for major repairs (e.g. roofs, furnaces, foundations), although these sometimes are for very short terms and/or have high interest rates;

3. Modifying the existing mortgage loan (if you are behind on payments this may be the only practical option) by applying to the current lender/servicer for “loss mitigation” or workout assistance
4. A second mortgage or home equity line of credit (HELOC) will also require good credit, payment history, equity in the property etc. It won't affect your interest rate on the first mortgage but will be an additional monthly payment. Second mortgages have a set amount, interest rate, and monthly payment. A HELOC works differently. It lets the borrower use a line of credit for things like repairs, taxes, or purchases. Because of this, the amount of debt can change, and the monthly payments change depending on how much is borrowed.
5. Reverse mortgages for homeowners over age 62 who have substantial equity in their homes can pay off the mortgage and provide cash for repairs/taxes or other expenses. Generally the homeowner does not make mortgage payments, but must pay for property taxes and insurance on the house. The downside is that as time goes by, the mortgage goes up instead of down as interest is added so the homeowner loses their investment in the property and cannot leave it to family without paying off the debt.
<https://www.consumerfinance.gov/ask-cfpb/can-anyone-take-out-a-reverse-mortgage-loan-en-227>.

Risks of Refinancing

If payments are not made on a second mortgage/HELOC, the lender can foreclose in the same way the first mortgage lender can. If mortgage rates are higher than when you first bought your home, refinancing will probably increase payments unless a longer term is available. (going from 20 to 30 years for example) Repeated refinancing to pay off credit card debt, as happened in the early 2000's, can lead to unaffordable mortgage payments and even ending up “underwater” if the housing bubble bursts as happened in 2007-09, so the house is worth less than you owe. Bankruptcy can eliminate credit cards and judgment debt while you keep the house as long as you pay the mortgage. A HUD housing counselor can help evaluate your budget to figure out what you can afford. <https://www.consumerfinance.gov/find-a-housing-counselor> or call the HOPE™ Hotline, 24 hours a day, seven days a week, at (888) 995-HOPE (4673).

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