# Freddie Mac Notes Increase in Cash Out Refinancing

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The third quarter of 2004 saw a surge in the number of Americans who tapped into their home�s equity when refinancing existing mortgages.

Last week Freddie Mac reported that Americans have returned, at least temporarily, to a pattern of �cash out� refinancing not seen for several years. 60% of mortgage refinancing in the third quarter of 2004 met Freddie�s benchmark for such lending; a new mortgage amount 5% higher than the unpaid principal balance of one being refinanced.

Since the period ending June 30, 2002, mortgage refinancing has apparently been all about lower interest rates. During those eight quarters only 33 to 44 percent of refinances have met the cash out criteria. In fact, twice during this period nearly a quarter of the new mortgages were for a lesser amount than the mortgages being replaced. This suggests that homeowners were throwing savings or other funds on the table to increase rather than tap into home equity.

Even at 60%, the cash out rate is still low by recent historical standards. During the fourth quarter of 1999 through the end of 2000 cash outs represented 74 to 81% of all refinances. Also during that same period, homeowners frequently exchanged an existing mortgage for one at a higher interest rate. These refinances resulted in a median (half of borrowers did better, half worse) mortgage interest rate 0.2 percent higher than the mortgage being refinanced. In other words, homeowners were willing to pay a premium to get their hands on cash.

Today�s borrowers are doing much better. During the most recent quarter, refinancing resulted in a new mortgage with a median interest rate 14% lower than the old one. The average reduction was 0.68 points for a savings of $67 per month on an average loan size of $150.000. Amy Crews Cutts, Freddie Mac deputy chief economist, stated �In aggregate, homeowners that have refinanced their mortgages this year are saving $450 million a month in lower interest costs. These savings offset some of the burdens on families from higher gasoline prices and home heating costs.�

Freddie Mac does not collect information on the reasons homeowners take cash out of their homes, but debt consolidation, home improvements, or college expenses are traditionally the most common reasons. No matter the motive, cash out refinances resulted in a $41 billion cash infusion into the economy in the third quarter of 2004 and Freddie Mac estimates a cash-out total of $118 for the year.

Refinances dipped to 40% of all mortgages issued in the third quarter of 2004, the remainder going toward home purchases. This was, no doubt, a function of interest rates that had increased to 6% plus during that time period. Rates have now dropped again to 5.7% so refinancing will probably nudge up again this quarter. Ms. Cutts, however, pointed out that very few mortgages still exist with rates above 6.5 percent so it is unlikely that the refi share will exceed 50% or stay there long if it does.

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