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Refinance Smarter

Why Smaller Rate Drops Matter More Today

With mortgage rates continuing to remain stubbornly high, many borrowers have taken out loans in the past 24 months at rates around 7%.

As rates begin to decline, a substantial number of borrowers will be looking to refinance their loans and lower their monthly payments.

For as long as I can remember, the old adage to determine the best time to refinance your home was when rates dropped by 1%. This was an easy way for borrowers and lenders to identify when it would make sense to spend the time and money to refinance your home loan and reduce your monthly payment.

As home prices have escalated over the past decade, I started to wonder if this philosophy has become outdated. Is it time to look at refinancing differently?

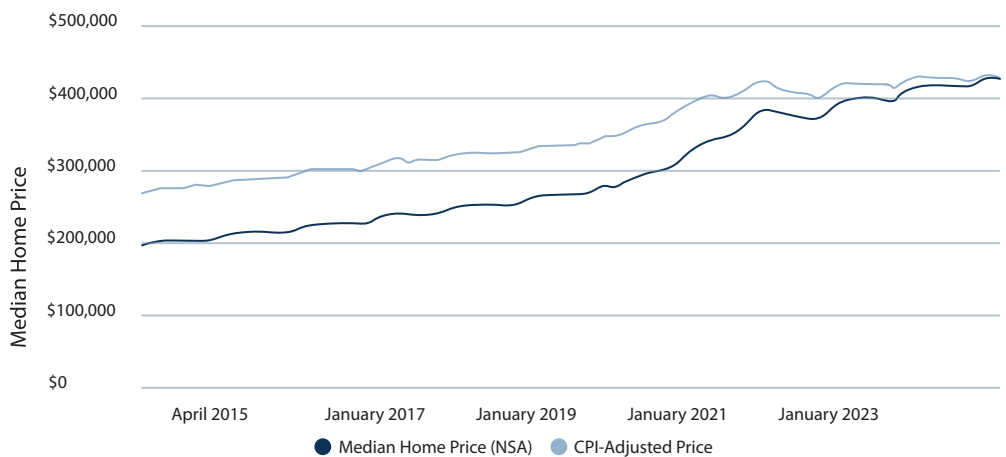
In 2015, the average home price was \$200,000. Now, a decade later, that average price has more than doubled to \$415,000. See the table below. This significant escalation in home prices means larger loan sizes too. Larger loans mean greater impact to the borrower's monthly cash flow with smaller rate movements.

Loan Scenarios and Impact

A \$200,000 home loan with an interest rate of 6.5% generates a monthly P&I of \$1,264 while

Median Home Price in the United States (DQYDJ)

Data from www.dqydj.com/historical-home-prices



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Chris has been at FHLBank Topeka since 2005 and previously worked for a community bank. He is a graduate of Emporia State University.

the \$415,000 loan with the same rate has a P&I of \$2,623. In the past, we would wait to discuss refinancing until the market rate reached 5.5%, but in the current environment, we may have reason to discuss a refinance with a borrower earlier.

If we look at the \$415,000 loan and lower the interest rate to 6%, the P&I amount decreases to \$2,488 or a reduction of \$135 per month and more than \$1,600 annually. In contrast, the reduction on the \$200,000 is less than \$800 annually, not quite the same impact for the borrower.

In fact, it takes a rate reduction of more than 100 basis points in order for the \$200,000 loan to see the same financial benefit as the 50-basis point reduction on the \$415,000 loan.

While the percentage amount of payment reduction is identical between the two loans, 5%, the dollar amount of change, is significantly different. As loan sizes continue to rise, that dollar amount will as well, making the rate reduction needed for material impact less and less.

In many of our markets, average home prices are well above \$415,000, making the potential P&I reduction to borrowers even more significant at smaller rate drops.

Refinance for Everyone!

Not quite. Obviously, the numbers are simply

a starting point. You and your borrowers will need to determine if a refinance makes sense. We would never advocate for you to suggest a refinance simply to do so, but many borrowers may not know their options and the potential benefits.

What these figures show us is that while the 1% rule has worked historically, your borrowers can benefit from a rate-term refinance well before you reach a full 1% rate drop as home prices and loan amounts continue to increase.

Review your pipeline from the past two years. How many borrowers are already in range for a refinance opportunity? With the MPF® Program, you can offer competitive execution, retain servicing and earn credit enhancement income – all while helping your borrowers save.

It is never too early to start the conversation with your borrowers, let them know the potential benefits to a refinance. If you don't ... somebody else will.

Conclusion

The dramatic increases in home values over the past decade (more than \$100K in the past two years alone), are changing some of the benchmarks we have used for targeting transactions with our borrowers. One of those to rethink is the need for your interest rate to decline by 1% before a refinance makes sense.

Loan Amt	Rate	P&I	Rate	P&I	Difference	Annualized
\$200,000	6.5%	\$1,264	6%	\$1,200	\$64	\$768
\$415,000	6.5%	\$2,623	6%	\$2,488	\$135	\$1,620

Loan Amt	Rate	P&I	Rate	P&I	Difference	Annualized
\$200,000	6.5%	\$1,264	5.45%	\$1,129	\$135	\$1,620
\$415,000	6.5%	\$2,623	6%	\$2,488	\$135	\$1,620

Contact Chris today for solutions that work for you.

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