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Amid Today's Rising Interest Rates, Let's Revisit the Concept of Buying Down Those Rates

Let's Talk Home Financing

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With mortgage rates rising and many homebuyers believing that ***now is the time to buy***, anything that can reduce the cost of a mortgage is worth looking into. Many savvy homebuyers are asking about discount points, wanting to know what they are and whether it makes sense to buy them.

Mortgage points, often referred to as discount points, let you make a tradeoff between your upfront costs and your monthly payment. By paying points, you are essentially buying down the interest rate. You pay more upfront, but you receive a lower interest rate, decreasing your monthly payments.

The cost of one discount point is equivalent to 1% of the total mortgage. In other words, if you had a $400,000 loan, the cost of purchasing one discount point would be $4,000. Lenders typically allow a borrower to purchase up to three discount points, and they can also be purchased in increments of one-half point.

The specific amount that an interest rate will be reduced with the purchase of points varies from loan to loan, but can generally be thought of as a 0.25% rate reduction for each point purchased. Thus, if you had an initial interest rate of 5% and purchased 3 discount points, your new interest rate would be 4.25%.

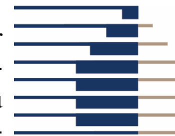
How do you know if it makes financial sense to pay for points? The first step is to calculate how long it will take for the decreased monthly payments to pay for the added upfront fee. This is called the "breakeven point." You can determine when you will break even by dividing the total cost of the discount points by the monthly savings. The answer will be the number of months it will take. Divide this number by 12 to find the number of years it will take.

Here's an example to show how it would work for you. The cost of buying down the rate from 5% to 4.25% on a $400,000 loan would be $12,000. The difference in the monthly principal and interest ("P&I") payment between 5% and 4.25% would be $178 per month ($2,138 P&I at 5% versus $1,960 P&I at 4.25%). If you are spending $12,000 to save $178 per month, you will need to own the property for 67 months in order to break even.

If you were to sell the home or pay off the loan (including by refinancing) in the first 5½ years, you would not be reaping the full benefit of your rate buy-down from buying points.

On the other hand, if you bought down the rate to 4.25% and stayed in your home for thirty years, the difference in monthly payments over the life of your 30-year loan would be $64,080. Subtracting the initial investment of $12,000, you would be left with a savings of roughly $52,000. As you can see, whether paying points makes sense for you depends primarily on one major factor — how long you think you will keep your home and/or the mortgage on it. If you don't plan on keeping your home for very long, or plan on refinancing in the near future, it may not benefit you to purchase points.

Purchasing a home is a major financial step. If you aren't sure how long you will be in the property, you may decide that the money spent on points would be better spent on furnishing or fixing up the property, or by simply investing it in another financial instrument that will gain value over time.



Jaxzann Riggs of **The Mortgage Network** helped me with this column. You can reach her at **303-990-2992** for more information about points and to discuss whether they may be right for your personal financial journey.