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Lenders Are Offering Interest Rate Buydowns to Reduce Initial Payments

Last week one of my listings went under contract for full price but with a seller concession to fund an interest rate buydown. I asked **Jaxzann Riggs** of **The Mortgage Network** to help me explain the process for my readers. She contributed to the following explanation.

At the start of 2023, many experts suggested that mortgage rates would gradually decline throughout the year and that housing prices would plummet. While borrowers sat uneasily on the sidelines watching the market, rates continued to climb higher, eventually moving above 7.5% in late August. But housing prices don't appear to be going lower any time soon. Some areas have experienced minor corrections, but values have remained relatively unchanged, making rising rates even more painful for prospective purchasers.

Enter Interest Rate Buydowns…

There are two types of interest rate buydowns — temporary and permanent. Each has their own benefits. It has been a common practice for borrowers to utilize permanent buydowns, referred to as "paying points" to the lender to reduce the interest rate, making housing more affordable. Temporary buydowns, popular during the era of double-digit rates, fell out of favor in the past couple decades, but they're making a comeback.

A **temporary buydown** allows the seller or the buyer to contribute money to an account (held by the lender) at the time of closing. Funds are withdrawn from the account each month and used to subsidize the borrowers' monthly payment for a specific amount of time. A **2-1 Buydown** is a popular option that reduces the interest rate paid by the borrower for the first two years. The rate is 2% lower the first year and 1% lower in the second year, hence the name "2-1 Buydown." To ensure that borrowers can afford the full monthly payment, they must qualify for the loan based upon the higher payment, beginning in year 3 of the loan.

Here's How a 2-1 Buydown Would Work:

Let's assume a loan amount of $695,000 and that the interest rate without any buydown is 7.5% (often referred to as a "par" rate). By utilizing a temporary 2-1 buydown, the borrower's payments will look like this:

First year payment would be $3,946 based upon a 5.5% rate. In the second year the payment would increase to $4,442 at a rate of 6.5%.

At the end of the third year, funds in the "buydown account" have been exhausted and future payments ($4,859) are based upon the original 7.5% rate. The cost of the buydown is the difference between the "bought down" rate and the par rate. In the example used above, the total buydown cost would be approximately $16,560.

While the effects of this option only last a couple of years, the monthly savings are significant and for borrowers who anticipate increases in income, this can bring home ownership back into focus.

Temporary buydowns are appealing because many economists (and consumers) believe that interest rates are likely to fall in the next 12-18 months. If they are correct, and the borrower decides before the third year to refinance at a lower rate, any funds remaining in the buydown account are used to reduce the loan balance.

Permanent buydowns allow the rate to be "bought down" for the life of the loan, so monthly savings aren't quite as dramatic, but the lower rate continues through the life of the mortgage. The bottom line is that buydowns make sense for some and sellers who are willing to participate in the cost of buydowns will dramatically increase the pool of buyers.

If you would like more information about buydowns, call **Jaxzann Riggs** at **303-990-2992**.