



I'm buying a new home. Should I pay points? (30 Year Fixed Rate)

“Points” equate to money you spend to buy down the rate on your mortgage. One point is equal to 1% of your loan amount. For a fixed rate mortgage, one point will, at best, reduce the interest rate one quarter percent (.25%). The following are ways you may be charged points:

- An Origination Fee
- A Discount Point or a Discount Fee
- A Mortgage Broker Fee

Studies show that consumers believe that if they can obtain even a 1/8% or 1/4% lower interest rate on their mortgage that they will save tens and tens of thousands of dollars in interest. As a result, consumers have become extremely interest rate focused and, as a result, are willing to dole out thousands of dollars in points to get the illusive, lower interest rate. To put things in perspective, consider that you are obtaining a 30 year fixed rate mortgage in the amount of \$250,000. Your Loan Officer tells you he can offer you a rate of 6.25% with no points (monthly payment of \$1,539), or if you pay a 1% Origination fee (\$2,500) he can get you a lower rate of 6.00% (monthly payment of \$1,499). Note that you “save” \$40 per month if you spend \$2,500 in points. The question then becomes, “Is paying points a good deal for you”?

In order to answer that question you need additional information. Following is a 10 year financial analysis comparing the two loan options after 10 years:

SNAPSHOT AFTER 10 YEARS:

	<u>Paying 1 Pt for 6.00%</u>	<u>Paying 0 Pts. for 6.25%</u>
Total interest paid:	\$139,106	\$145,605
Principal balance:	\$209,213	\$210,594
Savings account balance	\$5,505 *	\$3,320 **

* the after tax value of \$40 per month deposited into a 4.00% savings account for 120 months

** the after tax value of \$2,500 deposited into a 4.00% savings account after 120 months.

10 YEAR ANALYSIS:

28% tax savings on interest paid @ the 6.25% rate:	(\$1,828)	(\$145,605 - \$139,106 times .28)
Lower principal balance @ the 6.00% rate:	\$1,381	(\$210,594 – \$209,213)
Monthly payment savings in savings account from the 6.00% rate:	\$5,505*	
After tax value of \$2,500 deposited in savings account:	<u>(\$3,320)**</u>	
Net after tax savings from the 6.00% rate after 10 years:	\$1,738	

CONCLUSION:

A 2001 Harvard University study confirmed that the average time a mortgage in America is held is **less than two (2) years** yet, in our example if the borrower pays points to buy the rate down to 6.00% the borrower must hold the loan a minimum of 5 years (\$2,500 divided by the \$40 monthly savings equals 5 years) just to break even on the money spent. This means that if the borrower refinances or sells the home within the first 5 years they will not earn back the money spent to buy the rate down, **they will actually lose money!** If the borrower does defy the odds and actually holds the loan for 10 full years, the net savings will amount to \$1,738, or \$173.80 per year.

National averages indicate that most Americans will not hold the same loan after 5 years, much less 10 years. Further, most American’s interviewed believed that if they could lower their interest rate by one quarter percent their savings over a 10 year period would be substantially more than indicated in the above example. Faced with these facts, most borrowers concluded that paying points to obtain a lower interest rate was generally not in their best interest.