Title:
Does Paying Points on a Mortgage Make Sense?

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513

Summary:
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Keywords:
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Article Body:
You've found your dream home and are now ready to start shopping for a mortgage. Several lenders have talked about points. You've heard that paying points is the only way to get a low interest rate. But is increasing your initial costs worth getting a lower rate?

For most people, paying points doesn't make sense. Points, also called discount points or origination fees, are each worth one percent of the loan amount. They are paid to the lender at closing.

Paying points basically allows the borrower to buy down the interest rate.

Points became popular in the early 1980s when mortgage rates were in excess of 15%. Most people could not afford the monthly payments that come with such high interest rates. Lenders began offering discounted rates at a certain fee. Sellers often paid the points in order to sell their properties. This gave buyers affordable mortgages and owners were able to sell their homes.

Times are different now. Interest rates are reasonable. There isn't a large need to pay a lot of money up front in order to get a lower rate.

Let's look at the numbers. You have contracted to purchase a home for $240,000. You have the 20% down, which leaves you with a mortgage of $192,000.

You find a 30-year fixed rate mortgage at 6.5% with two points. For closing, you will need to pay $3,840 ($192,000 x 2%) for the points.

The lender can also offer you a rate of 7% with no points.

What do you choose? The lower rate or the lower closing?

At 6.5% you will have a monthly principal and interest payment of $1,207. At 7% your payment increases to $1,270 each month. That's a difference of $63 per month. If you are looking for a monthly payment reduction, it's not really a significant one.

It will take you 61 months ($3,840 divided by $63) to recoup your points payment in the form of a lower payment. This is your payback period. But if you had the $3,840 still, it could be earning interest in the bank. If it gets 3% interest in the bank, it would earn about $10 per month. If you pay points, this is interest lost, so subtract $10 from your $63 per month savings. Now divide $53 into $3,840, and your payback period increases to 72 months -- six years.

So you have to live in your home for at least six years in order to take advantage of the savings that paying points gives you. Most people don't keep a mortgage for six years. Unless you are absolutely sure you will live in the home for the time period necessary to recoup your points, you should probably invest your money instead of putting towards points.

If you are looking at paying points in order to reduce your monthly housing payment, you may want to look at a less expensive property. Sixty dollars worth of savings isn't a lot if you have a tight budget. Chances are that if you have a tight budget to start with, finding extra money for closing would be difficult. And don't forget, taking out a side loan to get the money to pay points with is defeating the purpose.