RAISING THE BAR

A DECATO LAW OFFICE NEWSLETTER

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Is it worth paying points?

There are not a lot of bright spots when considering the current state of the economy. Layoffs and unemployment continue to be on the rise, companies we once considered cornerstones of the country are on the brink of bankruptcy, and taxpayers are being called upon to pay for bailouts for businesses that once epitomized progress and innovation. But with the bad news does come a little good news. Such is the case with mortgage rates.

Over the last few months, home mortgage rates have been in steady decline. As of the writing of this newsletter, one local bank is offering a thirty year fixed mortgage rate of 5.125%. Although low rates are prompting many to refinance existing home mortgages, those electing to refinance should not forget about the added savings that can be achieved by paying points.

Points represent a fee a borrower pays a lender at the time of the loan. Points are expressed in terms of a percent of the loan. For example, if one is considering a $100,000 loan, one point will mean the borrower has to make a cash payment to the lending institution of $1,000 (1% of $100,000). Paying two points will mean a payment of $2,000 (2% of $100,000). The benefit of paying points is reflected in a lower interest rate on the borrowed money. That local bank I referenced above, for example, is offering an interest rate of 4.75% with one point paid at time of closing, and an interest rate of 4.375% with two points paid at time of closing.

Paying points at the time of a closing is considered by some an investment strategy. The strategy can yield a return that increases the longer one stays in his/her loan. The return consists of the savings, in terms of monthly and total interest that will need to be paid on the loan, plus a lower loan balance in the month the loan is paid off.

Whether paying points is financially advantageous hinges, in large part, on the time period in which the borrower plans to stay with the loan. If a borrower acquires a 30 year, $200,000 fixed rate mortgage, but plans on selling his/her residence in two years and will pay off the loan at time of sale, paying $2,000 or $4,000 (to buy points) merely to acquire a lower interest rate would not make financial sense. But if this same borrower plans on staying in his/her residence for many years, the payment of points could result in a tremendous savings. Consider the following: If you were to acquire a $150,000 loan for 30 years at a fixed interest rate of 5.0%, you would pay approximately $140,000 in just interest over the life of the loan (this assumes you are not paying down the principal of your mortgage sooner than required under the mortgage documents). However, if you could buy two points for $3,000 (2% of $150,000) and get an interest rate of 4.5% for the loan, the interest you would pay over the life of the loan would be approximately $124,000. In the end, paying $3,000 for two points, which resulted in a lower interest rate, could save you approximately $16,000 over the life of the loan.

The savings in interest payments is not the only financial benefit realized with a lower interest rate. Again, let us consider an example: If you were to acquire a $150,000 loan for 30 years at a fixed rate of 5.0%, your monthly payment would be approximately $805.00. However, if you get an interest rate of 4.5% by buying points, your monthly payment would be approximately $760.00. The savings of $45.00/month could be used in any number of ways, including an investment yielding a high return.

Certainly, buying points is not for everyone. Coming up with cash at the time of closing may not be possible. Also, buying points may not be financially beneficial for someone planning on selling within a couple of years. Buying points, however, is merely an option to consider.

If you are considering borrowing money for a home mortgage, be sure and ask a loan officer whether points are available. If points are an option, ask the loan officer to explain the benefits and drawbacks of points as they relate to your specific loan. Also, spend a few minutes doing research on the internet. Find a mortgage calculator that incorporates point calculations. One example can be found at:

www.money-zine.com/Calculators/Mortgage-Calculators/Mortgage-Points-Calculator

Spending a little extra time exploring whether it is financially feasible and beneficial to buy a point or two could save and even make you thousands of dollars over many years.