

## What are Points?

Points are prepaid interest that can be paid to help reduce your mortgage interest rate. One point is equal to 1% of your loan amount. If you are borrowing \$100,000, one point equals 1% or \$1,000. Usually, you do not have to pay points, although some loan programs and lenders may require one point or more to be paid. (Points are also called origination fees, discount fees and/or broker fees.)

Below is an example of how rates and points work together on a 30 year fixed mortgage. One point will typically reduce the interest rate by ¼%, however, that can vary to some degree.

**(These numbers are based on a mortgage of \$150,000 and a corresponding Principal + Interest payment.)**

<b>Interest Rate</b>	<b>Points</b>	<b>Payment</b>	<b>Cost</b>	<b>Savings/Mo</b>	<b>Break Even Mos.</b>
<b>6.00%</b>	<b>0</b>	<b>\$ 899.33</b>	<b>\$ -</b>	<b>\$ -</b>	<b>0</b>
<b>5.75%</b>	<b>1</b>	<b>\$ 875.36</b>	<b>\$ 1,500</b>	<b>\$ 23.97</b>	<b>62.5</b>
<b>5.50%</b>	<b>2</b>	<b>\$ 851.69</b>	<b>\$ 3,000</b>	<b>\$ 47.64</b>	<b>62.9</b>
<b>5.25%</b>	<b>3</b>	<b>\$ 828.31</b>	<b>\$ 4,500</b>	<b>\$ 71.02</b>	<b>63.3</b>
<b>5.00%</b>	<b>4</b>	<b>\$ 805.24</b>	<b>\$ 6,000</b>	<b>\$ 94.09</b>	<b>63.7</b>

Points paid are typically tax deductible. (Please see your accountant to determine how this information pertains to you.) Points may be negotiated in your Agreement of Sale also, similar to closing costs. You can ask the seller to pay 1-2-3-4 points or a dollar amount similar to the cost of the points, if the loan program allows. Points paid by the seller are also, typically, your benefit in regards to tax deductibility. Even though the seller paid the points; you reap the benefit of the tax deduction. Seller paid points are an added bonus and potential tax refund when you file. (The tax deductibility of points is not taken into consideration when analyzing the “Break Even Months.”)

When does it make sense to pay points? This will differ with each family. You must look at several factors to make this determination.

1. Is there money available to pay the points?
2. Do you have sufficient money to cover closing costs and negotiate the seller to pay them?
3. Is there a better way to utilize the money you might spend on points; such as paying down non-tax deductible debt or investing for the future?
4. How long will you be in this home? Make note of the break-even time periods.
5. If the market is in a “high” interest rate environment, mortgage rates may drop in the future allowing you to refinance into a lower rate without paying points.
6. If rates are in a “low” environment and you will be in this home for a long period of time, the use of points may be beneficial to reduce the overall cost of the mortgage.

The bottom line is this... what’s the best use of your money at this time or can you negotiate to have the seller pay some or all of your point cost? Keep in mind, a reduction in interest rate via points can be more affordable than a home price reduction of a similar cost. Ask us about the “*Seller Rate-Reduction Strategy*.” By using a Mortgage Analysis Planner, available at FAIRWAY, you can determine the most effective, overall purchase and home financing strategy.

### **Courtesy of Ken Pederson**

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