Buying Down Points

By ALEX MASON | Green Shoot Media

Selecting a mortgage is a tough job filled with research, questions and some home study before signing on the dotted line.

A good loan officer will evaluate your unique situation to include how many years you intend to live in your new home, recommend a type of mortgage to match your fixed or fluctuating monthly income and offer you the opportunity to lower your interest rates and reduce your monthly payments with the "buying down points" technique.

In some cases, buying down points is the best approach to home financing, and the purchaser may wish to wait an extra few months to save the additional cash to get the discount. Ask your loan officer what he or she recommends for your current and future financial status, and ask them to formulate a plan especially for your unique and individual situation.

WHAT IS IT?

Buying down points is a means of financial leverage to plunk down some extra cash at the time of your signature in exchange for a favorable adjustment to your interest rate.

Each buy-down point equates to 1 percent of the balance financed, so if you have a $500,000 loan balance, each point would cost you $5,000.

HOW IT HELPS

Buying down points may require an uncomfortable amount of cash out of pocket in the beginning, but over the life of the loan, the homeowner will enjoy substantial savings and may be able to pay the mortgage off early.

Although the monthly savings may be less than $100, the long-term financial strategy is to keep your money in your wallet, where it belongs.

It may take several years to recoup your initial cash investment of buying down points, but a mortgage will follow you most of your life. It's important to consider your future income and retirement funds available in your later years.

THE BEST SITUATION

The home buyers who will benefit the most from buying down points are those who intend to keep the home for a longer period of time and opted for a fixed mortgage for 20, 30 or 40 years.

Because it takes nearly a decade to recoup the buying points strategy investment, the homeowner will not see a significant amount of mortgage payments saved unless he or she remains in the property for close to or exceeding the life of the loan.

IDEAL CANDIDATES

Home buyers who earn a fixed income, such as a standard salary that may or may not include bonuses, have a dependable cash flow and can plan for their future mortgage payments from a pattern of monthly income.

However, home buyers who earn their living through sales commissions or experience highs and lows with seasonal cash flow months may wish to explore buying down points to counter against tough times down the road.

In addition, it is important to understand your retirement package and all its benefits to carefully calculate what is going to be a comfortable monthly output on a mortgage in case your property is not paid off when you retire. If you are purchasing a home and your retirement will come before paying off the loan balance, it's smart financial shopping to use the buying down points program to enjoy a lower monthly payment and reduced balance at the end of the loan.

Alex Mason is a former real estate agent and mortgage broker living in Los Angeles.

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Buying down points — or paying interest at closing in exchange for a lower interest rate for the life of the loan — could save you thousands of dollars.

REAL ESTATE 101

Tax Implications

The Internal Revenue Service offers the following advice for the tax deduction for mortgage interest points:

"If you pay interest in advance for a period that goes beyond the end of the tax year, you must spread this interest over the tax years to which it applies. Generally, you can deduct in each year only the interest that qualifies as home mortgage interest for that year. An exception (discussed later) applies to points."

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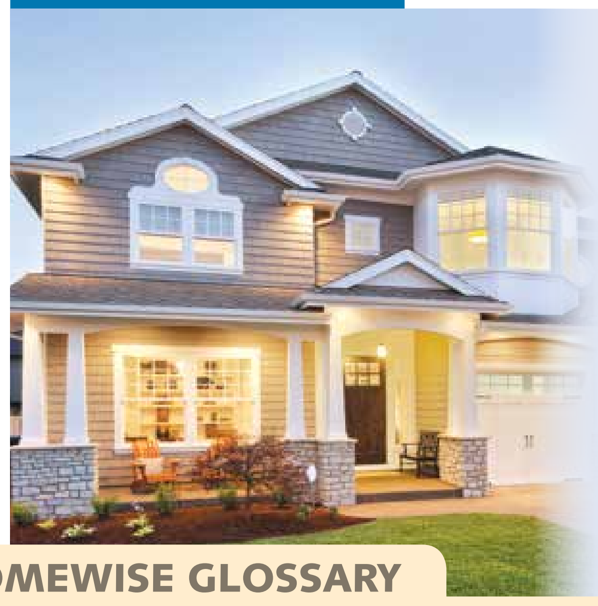

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HOMEWISE GLOSSARY

Financed permanent buydown mortgage: a mortgage for which the borrower has permanently reduced the interest rate by financing discount points in the loan amount.

Financing costs: discount points, loan fees, commitment fees, origination fees and/or similar fees associated with a mortgage transaction.

SOURCE: Freddie Mac